



This new section of eurofenix will bring you the most relevant news in the field of insolvency tech and digital assets. To contribute an article to a future edition, please send your proposal to: insolvencytech@insol-europe.org or the individual Chairs: **Dávid Oršula** david.orsula@bnt.eu **José Carles** j.carles@carlescuesta.es **Laurent Le Pajolec** lpa@exco.pl

Digital Gold: Implications of crypto assets under an insolvency scenario



The transactions of crypto assets are on the internet and therefore, considered as global



On 15 April, INSOL Europe and INSOL International held their joint Online Seminar 2021. Our co-chair David Orsula moderated the panel “Digital Gold: Treatment of Crypto Assets in Insolvency”, which started with a keynote speech by Professor Ignacio Tirado, Secretary-General at UNIDROIT.

Members of INSOL Europe’s Insolvency Tech & Digital Assets Wing, Lee Pascoe and Ilya Kokorin, discussed some of the latest cases at the intersection of insolvency and digital assets, which we summarize in this article.

Are cryptocurrencies property?

The transactions of crypto assets are on the internet and therefore, considered as global. However, the regulation on digital assets is fragmented, which creates uncertainty.

The main debate is **whether to recognize cryptocurrencies as property**. More and more jurisdictions provide such recognition.

- If considered property, the



second question would be whose property it is. Is cryptocurrency the property of a crypto-exchange or another crypto-custodian or does it belong to crypto-investors (e.g. customers of a crypto-exchange)?

- If cryptocurrencies are considered as the property of the investors, then their rights against an insolvent exchange may be of proprietary nature (versus a contractual nature).

In this regard, UNIDROIT is aware that international clarity is needed. It has recently established a working group designed to develop a legal instrument containing principles and legislative guidance in the area of private law and digital assets. According to its Secretary-

General, Professor Tirado, “*some sort of property right can and should be asserted over cryptocurrencies*”. However, the debate is not clear and there have been cases with different results in different jurisdictions:

- In the **Mt. Gox case** (once the largest bitcoin exchange in Japan), the Tokyo District Court decided that bitcoin was **not considered property under Japanese Law** (as it is not something tangible). Therefore, clients of the insolvent intermediary only had a contractual claim against the intermediary (and not proprietary rights).
- In the **Bitgrail case** (Italy) the Court of Florence decided that cryptocurrencies may be considered property. However, the crypto assets

were considered to be commingled, which gave rise to a relationship of irregular deposit. This led to the disappearance of the proprietary rights of investors, as the cryptocurrencies had become **property of the custodian**.

- In the **Cryptopia case** (New Zealand), the New Zealand High Court ruled that there was property but in the form of a trust. That is to say, crypto assets were not the property of the trustee, they were held on trust by Cryptopia for the account holders (a separate trust for every account holder). Therefore, they were the **property of the account holders**.

Main issues under insolvency

Identification and retrieval:

The first issue that a court-appointed insolvency practitioner will encounter is how **to find out if there are any crypto assets in the estate** of the insolvent debtor.

This information should be requested from the insolvent debtor. Nonetheless, there are other ways to investigate and see: if software associated to crypto assets can be found in the devices used by the insolvent debtor, if bank transfers of the insolvent company mention BTC or any terms related to crypto assets, if there are large files that could imply the download of blockchain, etc. Then the matter is how to obtain private keys and get access to the crypto wallets, holding crypto assets. The insolvency practitioner may use the tools available in their jurisdiction to obtain them (i.e. to subpoena the directors, workers, etc.).

Sometimes, crypto assets need to be retrieved. For example, in the **Dooga Ltd case**, the crypto register from the UK went bankrupt due to a hack in 2018 and the company hired experts to trace the crypto assets by doing

blockchain research and trying to link them to people or intermediaries. Fortunately, the experts found out the wallets with the stolen assets in two US cryptocurrency exchanges. After a Chapter 15 recognition in the US, the US Court ordered the turnover of the contents of certain accounts opened with Coinbase Inc and Bittrex Inc.

Preservation:

Once identified, cryptocurrencies should be preserved. Wallets can be accessible by people who have the private key, and as per the advice of the Australian Financial Service Authority, cryptocurrencies should be transferred to a wallet controlled by an insolvency practitioner. In this regard, it is recommendable that insolvency practitioners have an encrypted offline wallet (not connected to the Internet) ready-to-go in case they are appointed.

Not properly securing the crypto assets could lead (as it has indeed happened) to people with a private key accessing the wallet and stealing its content.

There is also a risk of a mistake in the transfer of digital assets between crypto addresses. In the **QuadrigaCX case**, crypto currencies for a value of 500,000 Canadian dollars were lost for a mistake of this sort (given the volatility in the value, those crypto currencies lost would be worth... over 7 million Canadian dollars at the date of the online seminar!).

Valuation and realisation:

We are all aware of the high market volatility and the constant change in prices of crypto assets.

If possible, it would be advisable that the Court sanctions the method for realisation of crypto assets, including its timing and methodology (e.g. over-the-counter trade, sale or exchange via a crypto-exchange, an auction or a public tender).

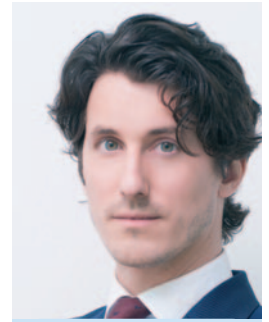
Distribution:

There would also be issues affecting the distribution (if a distribution *in specie* can be made or if the cryptocurrency needs to be converted into the local (*fiat*) currency prior to the distribution). In the Mt. Gox case, for example, the bankruptcy proceedings have been converted into a civil rehabilitation plan so that distributions could be made *in specie*.

Relevance of foreign judgements

Digital currency exchange insolvencies are large cross-border collapses, with creditors in several jurisdictions. As it is such a new area, insolvency practitioners involved in such insolvencies should look at what has happened in other jurisdictions. In fact, the decision in New Zealand has cited previous rulings from the UK and Singapore.

With this in mind, the Insolvency Tech & Digital Assets Wing is developing a case register of crypto assets and insolvency, which will be accessible through INSOL Europe's webpage. ■



JOSÉ CARLES
Lawyer, CARLES | CUESTA
Abogados, Madrid, Spain



LAURENT LE PAJOLEC
Accountant, EXCO A2A
Polska, Warsaw, Poland



DAVID ORSULA
Lawyer, Partner,
bnt attorneys in CEE,
Bratislava, Slovak Republic

Worldwide Digital Assets Case Register

A new Worldwide Digital Assets Case Register has been launched to provide a summary of cases and judgements concerning digital assets which will be useful for all insolvency specialists.

To see the register and find out how to contribute, visit:
www.insol-europe.org/worldwide-digital-assets-case-register