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Dávid Oršula *david.orsula@bnt.eu*
José Carles *j.carles@carlescuesta.es*
Laurent Le Pajolec *lpa@exco.pl*

Bitgrail & Celsius: Similar outcomes, different reasoning

Iacopo Donati and José Carles report on two different cases centering around the definition of cryptocurrencies as assets, one in Italy, the other in the US

IACOPO DONATI
Assistant Professor, University Ca' Foscari Venice, Italy

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Cryptocurrencies as fungible assets subject to ownership: The Bitgrail case in Italy

The Court of Florence, Bankruptcy Division, has found that cryptocurrencies (specifically, "Nanocoins") are property (fungible assets).[1] In *Bitgrail*, the main issue was whether an Italy-based cryptocurrency exchange company, which had lost 80% of the Nanocoins deposited by its clients due to a systems malfunction, met the pre-conditions for bankruptcy.[2] For that purpose, the Court preliminarily categorized cryptocurrencies and assessed their subjection to ownership. This interlocutory assessment – unprecedented in Italy and among the first in the world – brings significant implications for the treatment in bankruptcy of cryptocurrency depositors on a custodian platform.

Background

The Bitgrail platform functioned as follows: cryptocurrencies, once deposited by users in a personal wallet, would autonomously be transferred to a central wallet held by Bitgrail for each type of cryptocurrency. Bitgrail kept users' private keys for transfers of cryptocurrencies (a sort of passcode) and intermediated orders placed through the Bitgrail platform, updating the relevant client's balance accordingly.

In 2017, by exploiting a technical vulnerability of the Bitgrail platform, some users managed to embezzle Nanocoins worth €9.7 million. In more detail, this was made possible by the platform recording just the first withdrawal in cases of multiple orders for the same amount. The users could, thus, withdraw Nanocoins in excess of deposits (availability was enabled due to the centralization of the wallet). Moreover, the Nano protocol made any tracking impossible. As a result, Bitgrail quickly became unable to return the deposited Nanos to its clients, some of whom filed for insolvency in 2018.

The issue came down to Bitgrail's eligibility for bankruptcy and, particularly, on the size of its balance sheet assets and liabilities. The main focus of the decision is whether Bitgrail held the cryptocurrencies on behalf of users or, alternatively, had become the owner, under an obligation to return cryptocurrencies of the same number and kind upon a request by users.

The "reification" of cryptocurrencies

The Court of Florence ruled that cryptocurrencies are property. That qualification, uncontested by the parties, was grounded on the definition of "virtual currency" provided in the Italian Anti-Money Laundering Act.[3] That definition, stemming from EU law[4] (thus harmonized across Member States),[5] clearly stipulates the rise of a new asset within the legal domain (although not suitable to qualify as a "legally established currency"). In particular, the Court maintained that cryptocurrencies qualify as 'fungible assets', since they are units of the same quality and nature, fully interchangeable with each other.

The nature of the custodian-user contractual relationship

Under Italian law, a deposit arrangement concerning fungible assets grants the custodian ownership, under a duty to return assets of the same quality and quantity upon the depositor's request (an 'irregular deposit').[6] The parties can avoid a transfer of ownership by expressly agreeing that the custodian has no right to use the assets and must ensure they are distinguishable

from other assets of the same kind held by the custodian.[7] The Italian Court found that cryptocurrencies, once directed by the custodian to a single account, lose any element linking them to an identifiable depositor. Therefore, the exchange administrator acquires ownership in the cryptocurrencies and is under an obligation to return to the users an equal number of those assets (implying that Bitgrail met the assets and liabilities thresholds for bankruptcy).

Implications for the insolvency treatment of investments in digital assets

From a broader perspective, the Court's decision affects the treatment of cryptocurrency depositors on exchange platforms. Should the custodian become insolvent, depositors have no right to claim ownership under Italian law (unless the conditions for preventing the custodian from acquiring ownership are met.) Instead, the depositor is required to file a proof of claim for the value of the right *vis-à-vis* the custodian to have crypto-currencies of the same kind and quantity returned.

Celsius Network: US common law reasoning and a Bitgrail-like outcome

In the US, a similar solution to *Bitgrail* was reached at the beginning of 2023, albeit with very different reasoning. Instead of analysing the nature of an irregular deposit, as the Court of Florence did in *Bitgrail*, the US Bankruptcy Court of the Southern District of New York, in its decision of 4 January 2023,[8] analysed the terms of use between Celsius (a crypto lending online platform with operations globally and over 12 billion in assets under management prior to its Chapter 11) and the holders of certain deposits (Earn Accounts).

Ownership of cryptoassets: A contract law issue

In the Celsius Chapter 11, the debtors filed a motion to determine ownership of cryptoassets in Celsius' Earn Program and requested authorization to sell stablecoins worth $18 million. The battle over cryptocurrency ownership was of extreme relevance. If the stablecoins were the debtors' property, then the Earn Accounts' holders would merely be unsecured creditors with no direct claim over the stablecoins, and subject to distribution under a Chapter 11 plan or liquidation.

The Bankruptcy Court took a very practical approach: ownership of the assets is a **contract law issue.** Therefore, the Court analysed the terms of use between Celsius and the account holders. In this particular case, the terms of use were in the form of a "*clickwrap agreement*", an online agreement that "*requires an Account Holder to manifest assent by clicking a button confirming that they accept the terms or a button that implies that they have accepted the terms.*" Nevertheless, clickwrap agreements "*do not necessarily require the Account Holder to actually view the terms.*"

The Court stated that the traditional principles of (offline) contract formation also apply to electronic contracts. In this case, all the contract formation requirements are met:

- There is mutual assent (offer and acceptance), even in the case of clickwrap agreements under the applicable law (New York law).
- There is consideration.
- As the terms of use had been modified, the updated terms of use constituted valid and enforceable modifications of the contract.

Thus, there is a validly formed contract (the terms of use). His Honour Judge Martin Glenn analysed its exact wording because, if the contract's terms are unambiguous, under New York law the court must apply them as written.

The terms of use: Unambiguous grant of full ownership

In response, some creditors stated that there were references to "loans" in the terms of use of the clickwrap contracts that could lead the account holders to think they were granting a loan and not transferring ownership. However, the court stated that the unequivocal language of Celsius' terms of use made it very clear that all interest and rights of ownership in the cryptocurrency assets deposited by the account holders in the Earn Accounts were transferred to Celsius. Thus, the Court concluded that "*no ownership interest or lien in favour of the Account Holders was intended*" and that Celsius was the owner of the stablecoins.

Once it was clear that the stablecoins were property of the estate, the Court approved the sale under section § 363(b)1, because a "*sound business purpose*" was demonstrated. In this particular case, that purpose was the need for liquidity to fund the proceedings.

Relevance of the ruling

Cryptoinvestors and account holders should read carefully what they agree to when clicking *clickwrap contracts*. If the contract transfers the property in cryptoassets to the crypto lending companies or crypto exchanges, account or deposit holders should be aware they take the full risk in case of insolvency of online platforms, as the crypto becomes property of the insolvent estate. ■

Footnotes:

1 Court of Florence, 21st January 2019, n. 18.

2 The debtor met at least one of the following thresholds: (i) EUR 300k of assets, (ii) EUR 500k of liabilities, (iii) EUR 200k/year of revenues. See Articles 121(19 and 2(1)(d), Italian Insolvency Code.

3 Article 1(2)(qq), Legislative Decree No. 231/2007 (as amended by Legislative Decree No. 90/2017): "*virtual currency: a digital representation of value, which is neither issued by a central bank or a public authority, nor necessarily attached to a legally established currency, but used as a means of exchange for the purchase of goods and services and suitable to be transferred, stored and traded electronically*".

4 Article 3(1)(18), EU Directive No. 2015/849 (as amended by Directive 2018/843).

5 See, for instance, section 1(11), German Banking Act (KWG) (as amended in 2020).

6 Art. 1782 of the Italian Civil Code.

7 See P. Giudici, *Società* 2020, 590.

8 *In Re Celsius Network et al.* (Bankr. SDNY 2023).

JOSÉ CARLES
Co-Chair Insolvency Tech & Digital Assets Wing; Partner CARLES | CUESTA Abogados, Spain

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