

How Will Bankruptcy Courts Measure Customer Crypto Claims?

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In the wake of the industry's recent significant bankruptcy filings, crypto watchers are focusing for the first time on which crypto-entities are eligible for chapter 11 relief¹ under the U.S. Bankruptcy Code (the "Bankruptcy Code")² and, if so, whether, and under what circumstances, crypto-assets held by the debtor may become property of the debtor's "estate."³ As previously posted, if a customer's crypto-assets are deemed part of the debtor's estate, the customer may be treated as a general unsecured creditor and, thus, potentially stand to lose some or all of the value of the crypto-assets held by the Debtor. Conversely, if the customer's crypto-assets are not held to be part of the debtor's estate, such assets would not be available for distribution to the debtor's other creditors.⁴

Once this critical gating question is answered, one of the next significant issues is: how are the claims of customers whose crypto assets are determined to be property of the estate valued and measured under applicable bankruptcy law? The pending New York chapter 11 cases of Voyager Digital LLC (a crypto platform that allows customers to buy, sell, trade and store cryptocurrency) and Celsius Network (a crypto lending and custody platform that allows customers to earn rewards) could provide clarity, and establish precedent, on this open legal issue.

As background, section 502(b) of the Bankruptcy Code provides that the court "shall determine the amount of such claim in lawful currency of the United States as of the

¹ See Jeffrey Robins, *et al.*, *Are All Crypto Entities Eligible to File for Bankruptcy Under Chapter 11?* (August 2, 2022), <https://www.debevoisefintechblog.com/2022/08/02/are-all-crypto-entities-eligible-to-file-for-bankruptcy-under-chapter-11/>.

² The Bankruptcy Code is codified in Title 11 of the U.S. Code.

³ See Sidney Levinson, *et al.*, *Recent Crypto Bankruptcy Filings May Provide Clarity to Critical Unresolved Questions* (July 13, 2022), <https://www.debevoisefintechblog.com/2022/07/13/recent-crypto-bankruptcy-filings-may-provide-clarity-to-critical-unresolved-questions/>.

⁴ The Bankruptcy Code explicitly excludes from a debtor's estate any property in which a debtor holds only legal title and not an equitable interest, such as assets held by the debtor under trust, escrow, agency or bailment arrangements. 11 U.S.C. § 541(d). See also *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.10 (1983) ("Congress plainly excluded property of others held by the debtor in trust at the time of the filing of the petition.").

date of the filing of the [bankruptcy] petition.”⁵ Thus, the general rule is that all claims are valued in U.S. dollars as of the date of the bankruptcy filing. However, in light of the current crypto-market volatility, there could be significant differences between the value of a customer’s crypto-assets on the date of the bankruptcy filing, the date the chapter 11 plan is approved and the date of distributions to creditors. Further complicating the matter is that, unlike traditional creditors such as bondholders, vendors and suppliers, a significant number of customers in the pending crypto cases appear to prefer to receive distributions from the debtor in-kind rather than in the form of monetary payments.

Celsius Network recently disclosed that it does not intend to “dollarize” customers’ claims and will not seek to “give people back a recovery in fiat.”⁶ This means that customers could benefit from an increase or “rebound” (or, conversely, suffer a further decline) in the crypto market since the company’s July 2022 bankruptcy filing.⁷

On September 26, 2022, Voyager Digital announced that it has entered into a sale agreement with FTX US to sell its operations for approximately \$1.422 billion. The sale to FTX US will be consummated through Voyager’s chapter 11 plan. During a subsequent court hearing, Voyager’s counsel disclosed that under the proposed sale, Voyager customers who own crypto-assets supported on FTX’s platform would have the option to receive their distributions “in-kind” in a new FTX account. However, customers whose Voyager crypto-assets are not supported on FTX’s platform would receive cash distributions. In addition, with respect to any Voyager customer that has an FTX supported crypto position that does not elect to migrate to FTX’s platform upon closing, Voyager would be responsible to make any distributions under the anticipated chapter 11 plan, although whether such distributions will be made in crypto or cash remains an open question. On October 5, 2022, Voyager filed an amended chapter 11 plan and disclosure statement that will implement the sale with FTX. Among other things, the amended disclosure statement contains a chart of hypothetical recoveries for specific types of crypto-assets but notes that “Actual cryptocurrency recovery will be determined by cryptocurrency prices during the fair market value reference period prior

⁵ 11 U.S.C. § 502(b). Similarly, based on this statute, when a claim is denominated in currency other than United States dollars, its allowed amount is generally determined by converting the foreign currency into dollars at the exchange rate in effect on the petition date. See e.g., *Grupo Aeroméxico, S.A.B. de C.V.*, Case No. 20-11563 (SCC) (Bankr. S.D.N.Y.), Section 5.7 of *Order Confirming Debtors’ Joint Plan of Reorganization* (converting all asserted claims to U.S. dollars using the applicable foreign exchange rate in place on the petition date).

⁶ See *In re Celsius Networks, LLC*, Case No. 22-10964(MG) (Bankr. S.D.N.Y.) Aug. 16, 2022 Hr’g Tr.

⁷ It is noteworthy that when Celsius filed for bankruptcy protection, it informed the bankruptcy court that two of the key legal questions that will be critical to the chapter 11 case are “the amount of a crypto claim is determined as of what date” and “are customers entitled to return of crypto in-kind.”

to the [plan’s] Effective Date and may vary materially from illustrative recoveries presented herein depending on market conditions.”⁸

Bankruptcy is intended to be a collective process with a wide range of stakeholders that each have differing perspectives and interests. While Celsius’ disclosure regarding its intent not to “dollarize” customers’ crypto-related claims as of the bankruptcy filing date should appease a number of Celsius’ most vocal customers, certain of the debtor’s equity holders recently criticized the debtor’s position. This group of Celsius’ preferred equity holders recently filed a motion seeking the appointment of an official committee of equity holders to represent the interests of all equity holders. In support of the motion, the equity holders argued, among other things, that the Bankruptcy Code requires all claims to be valued as of the bankruptcy filing date and that the debtor would be improperly inflating the value of the customers’ claims by providing customers the benefit of any market appreciation of crypto-assets since the beginning of the case, “which could directly and negatively impact the Equity Holders’ recovery and violate section 502(b) of the Bankruptcy Code.”⁹ Under the Bankruptcy Code, holders of equity interests are only entitled to a recovery from the debtor’s remaining assets after all creditors’ claims have been satisfied in accordance with the priorities set forth in the Bankruptcy Code.¹⁰ Accordingly, the equity holders are seeking the appointment of a court-appointed fiduciary funded by the debtor to represent the interests of all equity holders in connection with the negotiations that will impact the type, and amount, of recoveries to be made under a chapter 11 plan.

As the recent Voyager announcement demonstrates, addressing the wide range of different crypto-assets presents significant practical and administrative challenges. Among other things, customers’ treatment may vary in accordance with the types of crypto-assets conveyed to the debtor. Moreover, as values fluctuate, certain customers could receive the full equivalent (or perhaps more than 100%) of their petition date claims in dollar terms while others may hold crypto-assets that decreased in value during the chapter 11 case. As a result, customers holding claims in the same class may

⁸ See *First Amended Disclosure Statement Relating to the Second Amended Joint Plan of Voyager Digital Holdings, Inc. and Its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code*, Case No. 22-10943(MEW) (Bankr. S.D.N.Y.), Docket No. 498, filed October 5, 2022. Voyager also disclosed that additional information regarding the “Customer Migration Protocol” will be filed at a later date.

⁹ See *Motion of Community First Partners, LLC, Celsius SPV Investors, LP, Celsius New SPV Investors, LP, and CDP Investissements Inc. for Entry of an Order Directing the Appointment of an Official Preferred Equity Committee*, Case No. 22-10964(MG) (Bankr. S.D.N.Y.), Docket No. 880, filed September 22, 2022.

¹⁰ Section 1129(b)(2) of the Bankruptcy Code codifies the payment hierarchy known as the “absolute priority rule,” which requires that creditors receive payment in full before holders of equity can receive or retain any property under a chapter 11 plan.

not receive the same substantive recovery under the plan, notwithstanding that the policy of chapter 11 is for all similarly situated creditors to receive equal treatment.¹¹

It is worth noting that in the 2020 bankruptcy case of crypto-lending platform Cred, Inc., the chapter 11 plan provided that customers could elect to receive a “good faith effort” to obtain distributions in the equivalent cryptocurrency in lieu of cash, although the plan trustee reserved the right to make distributions in cash if necessary.

Ultimately, this issue, which could have a material impact on recoveries, will likely not be resolved until the plan confirmation process at the end of the chapter 11 case. In light of the potential significant impact it may have on the type, and amount, of distributions to customers, we will continue to monitor these proceedings as courts address these novel crypto issues.

For more discussion and analysis of developments regarding bankruptcy law and crypto entities see our other posts:

- [Recent Disclosure Guidance Highlights Growing Concern Surrounding the Risks of User Assets Held by Various Crypto Custodians](#)
- [Recent Crypto Bankruptcy Filings May Provide Clarity to Critical Unresolved Questions](#)
- [Are All Crypto Entities Eligible to File for Bankruptcy Under Chapter 11?](#)

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¹¹ See *In re WR Grace & Co.*, 729 F. 3d 332, 344 n.8 (3d Cir. 2013) (“That is not to say that members of a class must receive the same amount of money for their claims. Rather, the claimants in a class must simply have the same opportunity for recovery.”).

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