

BY JASON B. BINFORD

The Role of Federal and State Regulators in Crypto Bankruptcies

President Joe Biden signed the Infrastructure Investment and Jobs Act on Nov. 15, 2021. Included in the sweeping legislation were federal consumer-reporting requirements for cryptocurrency gains, and requirements for businesses to report transactions where the purchaser pays more than \$10,000 worth of cryptocurrency.

On March 9, 2022, President Biden signed the executive order on Ensuring Responsible Development of Digital Assets,¹ noting that as of “November 2021, non-state-issued digital assets reached a combined market capitalization of \$3 trillion, up from approximately \$14 billion in early 2016.”² The order boasted that the U.S. has historically been a global leader in monetary regulation, but that a “growing development and adoption of digital assets and related innovations, as well as inconsistent controls to defend certain key risks, necessitate an evolution and alignment of the United States Government approach to digital assets.”³ To that end, President Biden ordered a wide array of federal agencies to conduct reviews and issue reports, including directing Secretary of the Treasury Janet Yellen to report on “policy recommendations, including potential regulatory and legislative actions, as appropriate, to protect United States consumers, investors, and businesses [in order to] support expanding access to safe and affordable financial services.”⁴

While state and federal governments were not ignoring cryptocurrency matters prior to 2022, regulators were generally taking a light touch with respect to the industry. This approach changed starting in July 2022 with the rapid-fire bankruptcies of several cryptocurrency-related businesses. The bankruptcy filing of FTX Trading Ltd. in particular created a “shift in tone ... [that] strengthened the hand of politicians and regulators calling for tougher enforcement.”⁵ Thus, the environment shifted from a light touch to regulatory “crypto carpet bombing,”⁶ which includes regulators taking an active role in the chapter 11 and 15 cryptocurrency cases currently on file.

This article discusses the role of state and federal regulators in recently filed crypto bankruptcy cases,

but is not intended as a comprehensive study of cryptocurrency regulation, and the analysis is based on public filings in each of the bankruptcy cases discussed. Therefore, to the extent that regulatory actions are being taken in relation to cryptocurrency debtors outside of what is described in pleadings filed on the docket (and news reports suggest that certainly seems to be the case), those out-of-court regulatory matters are not discussed. Rather, this analysis is a survey of the issues that regulators have chosen to take up in bankruptcy court cases.

Mt. Gox Co.

Before moving to more recent cryptocurrency cases, the *Mt. Gox Co.* case bears mentioning because it was the first bankruptcy case dealing with cryptocurrency matters. Mt. Gox Co. filed a chapter 15 petition in the U.S. Bankruptcy Court for the Northern District of Texas on March 9, 2014.⁷

Mt. Gox was a Japanese company that once was the largest online bitcoin exchange in the world. In February 2014, Mt. Gox filed for civil rehabilitation in Japan under Japanese law. The chapter 15 petition was thereafter filed seeking the bankruptcy court’s recognition of the Japanese action as the foreign main proceeding. Mt. Gox stated in its bankruptcy pleadings that a massive hack in early 2014 had stolen bitcoin from more than 750,000 Mt. Gox customers.⁸

The U.S. Trustee was involved in the *Mt. Gox* bankruptcy case in relation to such matters as the scope of the foreign representative.⁹ In addition, federal agencies, including the U.S. Secret Service and Department of Homeland Security, were involved in the case in relation to a settlement regarding the disposition of approximately \$5 million seized by the government prior to the bankruptcy filing.¹⁰ Other regulators, such as the Securities and Exchange Commission (SEC) and state regulatory agencies, did not appear in the *Mt. Gox* case. The chapter 15 case remains pending, with periodic updates being provided by the foreign representative regarding the progress of the civil rehabilitation in Japanese Court.¹¹



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1 Exec. Order No. 140607, 87 C.F.R. 130 (2022).

2 *Id.*

3 *Id.*

4 *Id.*

5 Dave Michaels, *et al.*, “Regulators Start Raising Heat on Crypto’s Biggest Players,” *Wall St. J.* (Feb. 14, 2023), at A1.

6 *Id.* (quoting Kristin Smith, chief executive of Blockchain Association).

7 Case No. 14-31229-sgj-15 (Bankr. N.D. Tex.).

8 See Docket No. 2, filed on March 9, 2014.

9 See Docket No. 85, filed on April 15, 2014.

10 See Docket No. 147, filed on Feb. 28, 2017.

11 See Docket No. 207, filed on Oct. 28, 2022.

Three Arrows Capital Ltd.

Three Arrows Capital Ltd. filed a chapter 15 case in the U.S. Bankruptcy Court for the Southern District of New York on July 1, 2022.¹² Three Arrows Capital is a hedge fund specializing in crypto investments that was based in Singapore and incorporated in the British Virgin Islands.¹³ This would end up being the first domino to fall in a quick succession of crypto bankruptcy filings.

Three Arrows “collapsed in excruciating and embarrassing fashion ... [resulting from] both recklessness and [alleged] criminal conduct” by its founders.¹⁴ In fact, some suggested that the failure of Three Arrows to make good on its commitments was one of the leading causes of the “crypto crash of 2022.”¹⁵ The foreign representatives for Three Arrows identified insolvency proceedings in the British Virgin Islands as the foreign main proceeding. Federal and state regulators have not made appearances in the *Three Arrows* bankruptcy case. The most recent filings have revolved around efforts by the foreign representative to force the company’s founders to provide information and testimony.¹⁶

Voyager Digital Holdings Inc.

Voyager Digital Holdings Inc. filed for chapter 11 in the U.S. Bankruptcy Court for the Southern District of New York on July 5, 2022.¹⁷ Voyager provides several services related to cryptocurrency. It operates a cryptocurrency brokerage platform, provides custodial services for customers to store their cryptocurrency, and provides cryptocurrency loans to other parties in the cryptocurrency sector.¹⁸ According to Voyager, the chapter 11 case was filed to effectuate an orderly restructuring and stop a short-term “run on the bank.” To that end, Voyager filed a chapter 11 reorganization plan contemporaneously with the petition.

Shortly thereafter, Voyager filed pleadings indicating that it would take a dual-track approach seeking either reorganization or a sale. Voyager then conducted an asset sale and chose an entity related to FTX Trading Ltd. as the winning bidder, but when FTX filed its own chapter 11 case, Voyager sought court approval of a relatively quick asset sale to Binance.US.¹⁹ Voyager sought to consummate the sale via a plan and disclosure statement. The plan also provided that Voyager would issue new cryptocurrency to pay creditors.

The U.S. Trustee has taken a very active role in the *Voyager* case, as have the SEC and state regulators, including the Texas State Securities Board and New Jersey Bureau of Securities. The regulators took issue with the proposed Binance.US sale, presenting various arguments, including that insufficient information related to the sale was being provided, and the sale as structured was unlawful because neither the debtors nor Binance.US were authorized to do business in the applicable jurisdictions.²⁰

The SEC’s objection included the assertion that Voyager’s issuance of new cryptocurrency was contrary to federal securities laws.²¹

The bankruptcy court took the matter in a consolidated hearing on the adequacy of the disclosure statement and plan confirmation. On March 10, 2023, the court overruled the various objections — including those raised by the regulators — and entered an order confirming the plan. The matters raised by the regulators are now subject to an appeal, and the parties have filed pleadings seeking a stay of the sale pending the appeal. The federal government has taken issue with the broad exculpations entered in the confirmation order, arguing that it amounted to a usurpation of the government’s police and regulatory powers.²²

[T]he issues described in the cases with significant regulatory activity remain subject to further development, including appeals to district courts and likely to the circuit court level.

Celsius Network LLC

Celsius Network LLC and its related companies filed chapter 11 petitions in the U.S. Bankruptcy Court for the Southern District of New York on July 13, 2022.²³ Just as in the *Voyager* case, federal and state regulators took a very active role in this case. While a number of different regulatory issues have been raised, the *Celsius* case is noteworthy for addressing the issue of privacy in chapter 11 cases, which has been especially complicated with respect to cryptocurrency cases, given that anonymity is often seen as an attractive feature of cryptocurrency ownership and use.

Celsius provided financial services to customers in the cryptocurrency industry, including establishing a platform for users to transfer their crypto assets and use them as collateral for loans. Celsius filed bankruptcy following certain “hiccups,” including the company’s inability to deploy assets on a profitable basis.²⁴ On Aug. 3, 2022, Celsius filed a motion seeking to redact certain personally identifiable information such as customer home addresses and emails,²⁵ then filed another motion seeking to redact customer names so that names and account numbers could not be aligned.²⁶

While the official committee of unsecured creditors supported the redactions, the U.S. Trustee did not, arguing that such redactions would be contrary to the general rule that bankruptcy proceedings be “open, public, and transparent.”²⁷ The bankruptcy court ultimately sided with the U.S. Trustee

12 Case No. 22-10920 (Bankr. S.D.N.Y.).

13 See Docket No. 37, filed on July 20, 2022.

14 Jen Wieczner, “The Crypto Geniuses Who Vaporized a Trillion Dollars,” *New York Magazine* (Aug. 15, 2022), available at nymag.com/intelligencer/article/three-arrows-capital-kyle-davies-su-zhu-crash.html (last visited March 24, 2023).

15 *Id.*

16 See Docket No. 81, filed on Feb. 7, 2023.

17 Case No. 22-10943 (Jointly Administered) (Bankr. S.D.N.Y.).

18 See Docket No. 15, filed on July 6, 2022.

19 See Docket No. 775, filed on Dec. 21, 2022. Binance.US and its affiliated companies operates the largest cryptocurrency exchange in the world.

20 See Docket No. 815, filed on Jan. 4, 2023.

21 See Docket No. 1047, filed on Feb. 22, 2023.

22 See Docket No. 1182, filed on March 14, 2023.

23 Case No. 22-10964 (Jointly Administered) (Bankr. S.D.N.Y.).

24 See Docket No. 23, filed on July 14, 2022.

25 See Docket No. 344.

26 See Docket No. 639.

27 See Docket No. 607.

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and allowed certain limited redactions, but otherwise found that redacting customer names was not permitted.²⁸

While the privacy issues in *Celsius* garnered a great deal of attention, the case also involved other regulatory issues. These included the court granting the U.S. Trustee's motion to appoint an examiner tasked with, among other things, determining how and where cryptocurrency assets were stored.²⁹ In addition, both the U.S. Trustee and state regulators filed objections to a proposed sale in the case, arguing that a sale should not take place until a determination of the nature and extent of Celsius's property interest in cryptocurrency assets was made by the court.³⁰ The bankruptcy court has entered an order approving bidding procedures for the sale of substantially all of Celsius's assets, but a sale order has not yet been entered.

FTX Trading Ltd.

FTX Trading Ltd. and related companies filed for chapter 11 in the U.S. Bankruptcy Court for the District of Delaware on Nov. 11, 2022.³¹ The declaration filed at the beginning of the case was made by restructuring professional John J. Ray, III. He had been named as CEO of FTX in the early morning hours of the petition date, and he did not mince words, stating that he has never "seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here. From compromised systems integrity and faulty regulatory oversight abroad, to the concentration of control in the hands of a very small group of inexperienced, unsophisticated and potentially compromised individuals, this situation is unprecedented."³² The case was further complicated by the fact that FTX's founder, Samuel Bankman-Fried, had been arrested and was facing the prospect of significant criminal liability. The dire nature of the case was further illustrated when FTX later acknowledged that it could not account for \$8.9 billion in customer funds.³³

The U.S. Trustee sought appointment of an examiner, arguing that it was necessary to investigate the "serious allegations of fraud, dishonesty, incompetence, misconduct, and mismanagement" by FTX.³⁴ State regulators have appeared

in the case from Texas, Wisconsin and Vermont. Generally speaking, the state regulators supported the U.S. Trustee's motion. However, the official committee of unsecured creditors opposed the appointment, asserting that FTX's new management and the committee were already conducting the needed investigations. The bankruptcy court ultimately sided with the committee, entering an order finding that appointment of an examiner was not required under the Bankruptcy Code and was not necessary under the facts of the case.³⁵

FTX has filed motions seeking to put into place procedures for the sale of certain assets.³⁶ On Jan. 12, 2023, the court — over objections, including by the U.S. Trustee — entered an order approving the bidding procedures for the sale of certain assets.³⁷ FTX filed its schedules and statements of financial affairs on March 15, 2023. Presumably, FTX will continue its "strategic review of [its] global assets"³⁸ and will file additional motions seeking to monetize its assets.

Additional Crypto Bankruptcy Cases and Conclusion

Following the *FTX* cases, there have been a handful of additional cryptocurrency-related bankruptcy cases, including *BlockFi Inc.*,³⁹ *Core Scientific Inc.*⁴⁰ and *Genesis Global Holdco LLC*.⁴¹ However, none of these cases have yet played out as venues for significant battles by regulators, but this could be because the cases have not been on file for a significant amount of time.

In addition, the issues described in the cases with significant regulatory activity remain subject to further development, including appeals to district courts and likely to the circuit court level. For now, it can be definitively stated that regulators will maintain a particular focus on cryptocurrency bankruptcy cases for the foreseeable future. **abi**

28 See Docket No. 910, filed on Sept. 28, 2022.

29 See Docket No. 820, filed on Sept. 14, 2022.

30 See, e.g., objection filed by the Texas State Securities Board and Texas Department of Banking at Docket No. 1059, filed on Oct. 14, 2022.

31 Case No. 22-11068 (Jointly Administered) (Bankr. D. Del.).

32 See Docket No. 24.

33 Alexander Saeedy, "FTX Says \$8.9 Billion in Customer Funds Are Missing," *Wall St. J.* (March 2, 2023).

34 See Docket No. 176.

35 See order at Docket No. 746, entered on Feb. 21, 2023. The U.S. Trustee, together with Wisconsin, Vermont and Texas, have filed a notice of appeal. See Docket No. 805.

36 See, e.g., motions and Docket Nos. 233 (related to a proposed sale of certain of FTX's "businesses") and 839 (relating to the proposed sale of FTX's interests in Sequoia Capital Fund LP).

37 See Docket No. 487.

38 Docket No. 233.

39 Case No. 22-19361 (Bankr. D.N.J.). BlockFi provides cryptocurrency-backed loans and interest-bearing accounts for cryptocurrency. See Docket No. 17. On Jan. 30, 2023, the bankruptcy court entered an order approving the procedures for an asset sale and a subsequent confirmation hearing. See Docket No. 441. The confirmation hearing currently is set to occur in May 2023.

40 Case No. 22-90341 (Bankr. S.D. Tex.). Core Scientific is a cryptocurrency hosting provider and mining company. See Docket No. 5.

41 Case No. 23-10063 (Bankr. S.D.N.Y.). Genesis operates a number of companies related to digital asset trading and lending. See Docket No. 17. Genesis filed a reorganization plan on Jan. 20, 2023. See Docket No. 20. Genesis has not yet filed a disclosure statement or otherwise sought to have a confirmation hearing set.

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