

Crypto Frame Taking Shape in Real Time

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In 2022, CNBC reported on the EthCC conference in Paris, a gathering for hardcore Ethereum developers and technologists. A special spinoff event was a limited invitation only rave party in the Catacombs of Paris, labyrinth of centuries-old tunnels 65 feet underground, which hold the skeletal remains of around six million Parisians.[1] Visiting the Catacombs is considered illegal, although it appears to be tolerated. The CNBC report portrayed the event as surrounded by secrecy. Multiple teams were assembled via an anonymous Telegram group and gathered across the 14th arrondissement of Paris to sneak into the underground landmark.

Meanwhile, on this side of the Atlantic Ocean, the crypto world navigated a different kind of labyrinth – those of a chapter 11 reorganization in U.S. bankruptcy courts. In July 2022, two crypto players filed chapter 11 petitions in the Bankruptcy Court for the Southern District of New York– Voyager Digital, LLC, and its affiliates, and Celsius Network LLC and its affiliates.

WHY IS THIS SIGNIFICANT?

Voyager Digital operates a cryptocurrency brokerage that allows customers to buy, sell, trade, and store cryptocurrency on an easy-to-use and “accessible-to-all” platform. In addition to providing brokerage services, Voyager offers custodial services for customers who store cryptocurrency on Voyager’s platform. Voyager provides loans, typically in the form of a specific type of cryptocurrency, to counterparties in the cryptocurrency sector to facilitate liquidity or trade settlement. Interest earned from the Company’s loans is passed along to customers, who earn a “yield” on their stored cryptocurrency. *See Declaration of Stephen Ehrlich, Chief Executive Officer of the Debtors in Support of Chapter 11 Petitions and First Day Motions, Doc. No. 15.*

Celsius is a cryptocurrency-based finance platform that provides financial services to institutional, corporate, and retail clients across over 100 countries. According to the filings, Celsius was created in 2017 to be one of the first cryptocurrency platforms to which users could transfer their crypto assets and (a) earn rewards on crypto assets and/or (b) take loans using those transferred crypto assets as collateral. Headquartered in Hoboken, New Jersey, Celsius has more than 1.7 million registered users and approximately 300,000 active users with account balances greater than \$100. *See Declaration of Alex Machinsky, Chief Executive Officer of Celsius Network LLC in Support of Chapter 11 Petitions and First Day Motions, Doc. No. 23.*

The bankruptcy court was flooded with letters from individuals who feel robbed by the debtors and call for return of their deposits. The treatment of crypto is not addressed in the Bankruptcy Code and the bankruptcy courts are just starting to grapple with the treatment of cryptocurrency as an asset in bankruptcy proceedings. In fact, cryptocurrency, for more than ten years, has been characterized by price volatility and uncertainty regarding its legal status. Yet, in 2021, the crypto market’s value skyrocketed from \$965 billion to as much as \$2.6 trillion, according to a Morningstar analysis.

After many years of debating whether cryptocurrency should be considered security or commodity and which federal agency

should be the primary regulator, the more important question for the retail customers is whether they could recover in kind from a crypto brokerage like Voyager or a platform like Celsius whose model resembles bank operations – take deposits and use the deposit to make loans, but without the regulatory oversight that banks experience and without FDIC protection.

For customers of securities brokers, there are regulatory mechanisms that provide certain protections. Securities brokers regulated by the Securities and Exchange Commission are subject to a net capital rule—they must cease operations before their assets fall below the level that allows customer claims to be met. In addition, broker-dealers must belong to the Securities Investor Protection Corporation (SIPC), which provides an insurance scheme whereby customers of failed broker-dealers may receive up to \$500,000 from the SIPC fund.

For customers dealing with futures, section 4d(a)(2) of the Commodity Exchange Act (C.E.A.) provides certain protections as it requires that customer funds received by a future commission merchant to margin, guarantee, or secure a customer's futures contracts be held in segregated accounts, and not be commingled with the funds of the future commission merchant itself, nor used to guarantee the trades or contracts of any person other than the customer. Futures commission merchants must compute daily the amount of segregated funds on hand and the amount required to be held. Any shortfall must be reported immediately to the Commodity Futures Trading Commission. 17 C.F.R. Section 1.32.

None of these protections would be available in these recent filings at first glance. These crypto reorganization proceedings could potentially chart the way forward and address critical questions like –

- Would cryptocurrency be treated as a commodity or currency, and when could it be treated as a security?
- How can the cryptocurrency be used in the marketplace to generate recovery, and what's the proper timing for valuation of crypto assets?
- Would withdrawals of accounts within the 90-day period before the filing be subject to avoidance actions?

[1] <https://www.cnbc.com/2022/07/19/ethcc-paris-crypto-developers-gather-as-turmoil-grips-industry.html>

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