Whose Coin Is It Anyway?

FTX, Voyager, and the Challenges of Bankruptcy in a Digital World.

by James English[1]

Introduction

On November 11, 2022, FTX, the world's second largest cryptocurrency exchange, entered into Chapter 11 bankruptcy, ending a dramatic week marked by users' funds being frozen, buyout proposals falling through, and speculative tweets from key parties.[2] While FTX is the largest insolvency of its kind, it is just one in a line of insolvencies that have shook the cryptocurrency world.[3] First, on June 12, 2022, cryptocurrency lending platform Celsius announced it was freezing withdrawals, followed by its Chapter 11 filing the next day.[4] On July 1, 2022, Voyager users' accounts were frozen due to problems with "processing withdrawals", one week later, Voyager filed for Chapter 11 bankruptcy as well. For those with funds left in FTX, Celsius and Voyager, questions arose of how users' cryptocurrency accounts will be treated in the bankruptcy proceeding. This article will explore the challenges faced by bankruptcy courts in the case of insolvent cryptocurrency institutions, focusing on the similarities and differences between FTX and Voyager.[5]

Chapter 11 bankruptcy is one of several types of bankruptcies that companies have the option of filing.[6] Chapter 11 is the "reorganization" chapter of the Bankruptcy Code, which allows a business to continue to operate while it restructures its debts.[7] Under Chapter 11, the business is given protection from creditors and allowed to develop a reorganization plan that must be supported by the vote of creditors and confirmed by the bankruptcy court.[8] Once the plan is confirmed and the plan becomes effective, the business can make payments to its creditors under

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[1] Special thanks to Bruce Grohsgal and Dan Mackrides for their help with editing.

[2] *Crypto Markets in Turmoil Over FTX Bankruptcy*, REUTERS (Nov. 11, 2022, 7:47 PM), https://www.reuters.com/technology/crypto-markets-turmoil-over-ftx-bankruptcy-2022-11-11/.

[3] Verne Kryptoff, et al., *Crypto Contagion From FTX's Implosion Threatens Other Companies: 'There Are Still Many More Bankruptcies'*, FORTUNE (Nov. 15, 2022), https://fortune.com/2022/11/15/crypto-contagion-ftx-voyager-blockfi/.

[4] *Celsius Network Files Chapter 11 Bankruptcy*, STATE OF VT. DEP'T. OF FIN. REGUL. (July 14, 2022, 12:00 PM), https://dfr.vermont.gov/consumer-alert/celsius-network-files-chapter-11-bankruptcy.

[5] Olga Kharif & Joanna Ossinger, *Crypto Lender Celsius Files for Bankruptcy After Cash Crunch*, BLOOMBERG (July 13, 2022 8:13 PM) https://www.bloomberg.com/news/articles/2022-07-14/crypto-lender-celsius-files-for-bankruptcy-in-cash-crunch#:~:text=Cryptocurrency%20lender%20Celsius%20Network%20Ltd,individual%20investors%20to%20steep%20losses; Hamza Shaban, *Crypto Broker Voyager Digital Files For Bankruptcy as Industry Falters*, WASHINGTON POST (July 6, 2022, 12:33 PM), https://www.washingtonpost.com/business/2022/07/06/voyager-bankruptcy-three-arrows/; *FTX to File for U.S. Bankruptcy Protection, CEO Bankman-Fried Resigns*, REUTERS (Nov. 11, 2022 9:38 AM), https://www.reuters.com/technology/ftx-says-will-file-us-bankruptcy-latest-blow-crypto-2022-11-11/.

[6] Bankruptcy, CORNELL LAW, https://www.law.cornell.edu/wex/bankruptcy (last accessed Dec. 2, 2022),

[7] *Id*.

[8] *Id*.

the terms of the plan and emerge from bankruptcy.[9] However, bankruptcies involving cryptocurrency present a new area of bankruptcy litigation.[10]

The cryptocurrency space exists on the same global scale as popular platforms such as Twitter or Instagram where posts from users are made across the globe;[11] cryptocurrencies have this same borderless scope. Yet, the legal implications, applicable regulations, and laws differ widely depending on your jurisdiction. The legal portion of this paper will focus only on the applicable US laws.[12] Voyager and Celsius have filed their bankruptcies in the Southern District of New York, and FTX has opted to file all but one of its 130 entities, including its international affiliates, for bankruptcy in the District of Delaware.[13] The only exception is FTX Australia, which will go through bankruptcy proceedings in Australia.[14] The corporate structure of FTX will leave interesting questions for the bankruptcy court as state laws and foreign laws, including those of an entity's domicile, are considered in bankruptcy cases.[15]

This article will presuppose some understanding of cryptocurrencies broadly.[16] It is an industry that saw wide growth over the last decade beginning with the birth of Bitcoin from its anonymous founder Satoshi Nakamoto.[17] Whether or not you believe the asset class is overvalued or has room for growth, the field is undoubtedly chock full of legal issues that have yet to be resolved. One of those domains is within our bankruptcy courts.[18] While there have been many notable expansions

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[9] *Id*.

[10] Olga Kharif & Joanna Ossinger, *Crypto Lender Celsius Files for Bankruptcy After Cash Crunch*, BLOOMBERG (July 13, 2022, 8:13 PM) https://www.bloomberg.com/news/articles/2022-07-14/crypto-lender-celsius-files-for-bankruptcy-in-cash-crunch#:~:text=Cryptocurrency%20lender%20Celsius%20Network%20Ltd,individual%20investors%20to%20steep%20losses

[11] *Will Bitcoin Ever Become a Means of Payment on the Global Scale?*, FINEXTRA (July 26, 2021), https://www.finextra.com/blogposting/20663/will-bitcoin-ever-become-a-means-of-payment-on-the-global-scale

[12] Bryce Elder, *Untangling the Knotty Empire of Bankman-Fried and FTX*, FIN. TIMES (Nov. 12, 2022), https://www.ft.com/content/c28e0570-d4c4-433c-b0a0-c99fba613822 (detailing the sprawling nature of FTXs corporate structure. The most interesting being FTX which was headquartered in the Bahamas but had an onshore entity in Delaware).

[13] *Id*.

[14] The FTX Australia entity has been carved out from this filing due to the cryptocurrency regulatory regime in Australia. While this is speculative, the increased regulation may have kept the FTX Australian entity solvent. https://www.coindesk.com/business/2022/11/11/ftx-australia-calls-in-the-administrators-report/

[15] *See* CFTC v. McDonnell, 287 F. Supp. 3d 213, 217 (E.D.N.Y. 2018) ("A 'commodity' encompasses virtual currency both in economic function and in the language of the statute."); *see also* Diamond Fortress Techs., Inc. v. EverID, Inc., 274 A.3d 287 (Del. Super. Ct. 2022); *see also* Christopher Donnelly, *Commodity or Currency: Interpreting U.S. Bankruptcy Courts and Code Approach to Cryptocurrency Classification*, DEL J. CORP. L. BLOG (Apr. 1, 2022), https://djcl.org/commodity-or-currency-interpreting-u-s-bankruptcy-courts-and-code-approach-to-cryptocurrency-classification/.

[16] . *How Does a Blockchain Prevent Double-Spending of Bitcoins?*, MEDIUM (Aug. 25, 2018), https://medium.com/innerquest-online/how-does-a-blockchain-prevent-double-spending-of-bitcoins-fa0ecf9849f7 (explaining the underlying technology of Bitcoin and cryptocurrencies like it known as blockchain. A general overview is that blockchain solves the double spend problem by rewarding a pool of diverse miners an incentive for "mining" a mathematic equation and ensuring all of the ledgers align. Prior to this, digital money experienced the problem of a single balance being spent twice).

[17] *See* Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (2008), https://bitcoin.org/bitcoin.pdf.

[18] Andrew Scurria & Soma Biswas, *FTX Collapses Into Bankruptcy System That Still Hasn't Figured out Crypto*, THE WALL ST. J. (Nov. 16, 2022, 5:30 AM), https://www.wsj.com/articles/ftx-collapses-into-bankruptcy-system-that-still-hasnt-figured-out-crypto-11668550688.

and contractions in cryptocurrency, there has only been one prior notable bankruptcy proceeding, the Mount Gox hack and subsequent insolvency in 2014, which took place in Japan.[19] The insolvencies covered here will likely eclipse Mount Gox in both the value and number of clients impacted. While there is a large amount of speculation about the events, particularly with regards to FTX, this article will focus on what is known and tangible.[20]

I. Distinguishing Bank Deposits from Cryptocurrency Exchange Deposits

A key tenet of cryptocurrency is the notion that you can truly "own" your coins. By having the private key to your cryptocurrency wallet, you and you alone possess the ability to store, save, give away, destroy, or lose the contents of that wallet. The content of a cryptocurrency wallet can range from Bitcoin, to NFTs, to specific voting rights in a DAO.[21] While there are different use cases for each, the ownership remains with whoever holds the keys to this wallet.[22] The expansion of a variety of cryptocurrency products has steadily eroded away at this central ethos of censorship-resistant ownership.[23]

The rise of exchanges where you can turn cash from your bank into cryptocurrency like Bitcoin or Ethereum, was a natural progression for the industry.[24] These exchanges offer users a convenient way of gaining exposure to this new asset class and millions of cryptocurrency owners rely on their services. While the cryptocurrency platforms appear to users like a bank and offer some of the same services, they lag banks in a few key areas. First, cryptocurrency, despite the name, is not currency.[25] While the classification of cryptocurrency is another currently unresolved legal issue, it tends to fall into two categories. For some of the first cryptocurrencies, such as

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[19] *Id*. (Mount Gox was the largest exchange for Bitcoin. Founded in 2010 at its peak it was servicing 70% of all Bitcoin transactions on the network. In 2014 the exchange was a victim of hack where all of its funds were either stolen or permanently lost. Initially, the exchange froze the ability to withdrawal claiming technical difficulties. Ultimately, it was revealed the nearly 400,000 Bitcoin has been lost (valued today at ten billion USD.) The hack dramatically impacted the price of Bitcoin, causing it to plummet. Subsequently, much of the funds were recovered from Mt. Gox but the bankruptcy proceedings would continue for years; each round of sales to pay off creditors often causing gyrations in the price of Bitcoin.)

[20] For those interested, I will provide an addendum that will lay out the more speculative side as well as the additional paths through bankruptcy, with this paper strictly focusing on the legal issues surrounding token ownership.

[21] Brian Nibley, *What is a Crypto Wallet?*, BUSINESS INSIDER (July 26, 2022 1:31 PM), https://www.businessinsider.com/personal-finance/crypto-wallet#:~:text=A%20crypto%20wallet%20is%20a%20software%20program%20or%20physical%20device,private%20keys%20and%20public%20keys.

[22] *Id*.

[23] Nathan Sexer, *Decentralized Exchanges vs. Centralized Exchanges: Overview*, CONSENSYS (Jan. 1, 2018), https://consensys.net/blog/news/decentralized-exchanges-overview-benefits-and-advantages-over-centralized-exchanges/.

[24] Benedict George, *What is Bitcoin Pizza Day?*, COINDESK (Aug. 5, 2022 12:21 PM) https://www.coindesk.com/learn/what-is-bitcoin-pizza-day/
(Initially, all cryptocurrency was obtained through mining. Then peer to peer networks formed in early Bitcoin forums leading to interesting interactions like the "Bitcoin Pizza" where a user exchanged 10,000 Bitcoins for someone else on the forum ordering him two pizzas. At the time, the 10,000 Bitcoins had an exchange value of approximately $41. Today, that same Bitcoin is worth approximately $150,000,000).

[25] *Tucker v. Chase Bank USA, N.A.*, 399 F. Supp. 3d 105, 108 (S.D.N.Y. 2019) ("Cryptocurrencies are not legal tender, do not represent a claim on legal tender, are not accepted as currency by the government, and are not accepted as payment by the "overwhelming majority of private business and individuals.").

Bitcoin and Ethereum, regulators have widely adopted the position that they are a commodity falling under the jurisdiction of the CFTC.[26] For newer cryptocurrencies, the SEC has taken the position that many, if not all of them, are securities, satisfying the four prongs of the Howey test.[27] The SEC has been prosecuting many of the initial coin offerings (ICOs) we have seen over the years, labelling them tantamount to unregistered securities offerings.[28]

Second, cryptocurrency exchanges are not FDIC insured.[29] In the United States, if an FDIC-insured bank becomes insolvent, the United States government will step in and refund up to $250,000 of your deposits.[30] This was a development that stemmed from the negative effects of the bank runs during the Great Depression.[31] Without the protection, as a customer of a bank, you are an unsecured creditor, where a default of your bank may lead to you receiving a fraction of what your bank account was worth.[32] In order to dissuade people from running to the bank during economic downturns, to protect their interests as unsecured creditors, the United States government guarantees your deposits.[33] Stockbrokers have a similar form of insurance known as SIPC, back-stopping up to $250,000 of cash in the account or a combined $500,000 of cash plus assets.[34] The SIPC is a private, federally mandated nonprofit organization that came out of the Securities Investor Protection Act of 1970.[35] As it stands today, cryptocurrency platforms do not have any of these federally mandated insurance programs.

Despite this, many cryptocurrency owners view cryptocurrency institutions, especially ones with significant assets under management, as quasi-banks.[36] For starters, many crypto exchanges have user interfaces similar to banks. The interface displays a balance, they offer you custody of your assets, and display a US dollar balance (USD).[37] Probably more akin to stock brokerage apps, many cryptocurrency platforms allow you to trade with other users, swapping Bitcoin for USD or Bitcoin for Ethereum, among other trading pairs. Finally, in the case of Voyager and Celsius, they offered depositors "high yield" accounts allowing investors to capture interest on their deposits,

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[26] Digital Assets, CFTC, https://www.cftc.gov/digitalassets/index.htm (last visited Nov. 18, 2022).
[27] *See Sec. & Exch. Comm'n v. LBRY, Inc.*, No. 21-CV-260-PB, 2022 WL 16744741, at *1, *3 (D.N.H. Nov. 7, 2022).
[28] *Id*.
[29] Seth P. Rosebrock, *Potential Violations of Sections 18(a)(4) of the Federal Deposit Insurance Act*, FDIC (Aug. 18, 2022), https://www.fdic.gov/news/press-releases/2022/cryptosec-info-letter.pdf.
[30] Robert Stammers, The History of the FDIC, INVESTOPEDIA, (Aug. 31, 2021), https://www.investopedia.com/articles/economics/09/fdic-history.asp.
[31] *Id*.
[32] Rufas Kamau, *People Misunderstand Cash Deposit in Banking and Ignore Bitcoin*, FORBES (June 1, 2022, 12:24 PM), https://web.archive.org/web/20221012130057/https://www.forbes.com/sites/rufaskamau/2022/06/01/people-misunderstand-cash-deposit-in-banking-and-ignore-bitcoin/.
[33] *Id*.
[34] What SIPC Protects, SIPC, https://www.sipc.org/for-investors/what-sipc-protects (last visited Nov. 18, 2022).
[35] Milana Budisavljevic, *SIPC vs. FDIC: Insurance Protection Differences*, First Republic Bank (May 19, 2022), firstrepublic.com/insights-education/sipc-vs-fdic-insurance-protection-differences
[36] William D. O'Connell, *Crypto Platforms Say They're Exchanges, But They're More Like Banks*, THE CONVERSATION (Aug. 11, 2022), https://theconversation.com/crypto-platforms-say-theyre-exchanges-but-theyre-more-like-banks-188339.
[37] *See, e.g.,* COINBASE, www.coinbase.com (last visited Dec. 2, 2022).

eclipsing even the most lucrative traditional bank savings accounts by many folds.[38] Theoretically, those with deposits at banks and stock brokerages and those with deposits at cryptocurrency exchanges are in very similar positions, the huge disparity being the FDIC and SIPC insurance offered to those in traditional finance.

II. What is Subject the Bankruptcy Estate?

When you purchase cryptocurrency on an exchange, what happens to it and where does it go? After exchanges debit your bank account, you are given the equivalent amount in US dollars or a cryptocurrency stablecoin.[39] With this money you can then buy Bitcoin from the exchange on their exchange page. After purchasing Bitcoin, the "keys" to your coins need to be stored somewhere. For exchanges this method of storage tends to split into two categories, "cold wallets" and "hot wallets."[40] A cold wallet is an electronic storage system that has never been connected to the internet.[41] This is important from a cyber security perspective as cold wallets are much less subject to theft.[42] For logistical reasons, a cryptocurrency exchange cannot hold all of their customers' balances offline, so a certain amount is held in a hot wallet. This is the pool of money an exchange would have on hand to promote liquidity, process purchases and withdrawals, offering a smoother experience for the user.

After you purchase your cryptocurrency, you can then decide to take it off the exchange and become a custodian of it yourself in your own hot or cold wallet. Alternatively, you can leave it on the exchange, which allows you to buy or sell it whenever you need to. For a variety of reasons, many users opt to keep their currency on the exchanges. For those who want to be invested in the technology, the idea of taking custody of your own cryptocurrency and potentially losing it forever by mistyping one letter or losing a flash drive can be daunting.[43] For others, trading cryptocurrencies may be their job; buying when they think it will rise and selling at market tops, keeping a balance of USD in their cryptocurrency accounts as "buying power" for quick purchases.

When signing up for an exchange, you are presented with a terms of service agreement. Throughout this story, terms of service agreements play an important role of showing what the

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[38] Danny Nelson & David Morris, *Behind Voyager's Fall: Crypto Broker Acted Like a Bank, Went Bankrupt*, COINDESK (July 13, 2022 3:06 PM), https://www.coindesk.com/layer2/2022/07/12/behind-voyagers-fall-crypto-broker-acted-like-a-bank-went-bankrupt/ (Voyager was able to capture competitive rates for their customers essentially relied on a lot of their balance sheet consisting of loans to trading firms who needed the liquidity to trade and would then return the funds to Voyager and pay interest on the loans. This is a fairly common practice in traditional finance but creates counterparty risk. This risk is amplified when a significant portion of your lending is taking place with just a single entity and that entity is involved in speculative trading on the cryptocurrency market.)

[39] Adam Hayes, *Stablecoins: Definitions, How They Work, and Types*, INVESTOPEDIA (Oct. 4, 2022), https://www.investopedia.com/terms/s/stablecoin.asp (A stable coin is a term for any number of products in the cryptocurrency community that tend to "peg" to an absolute value, typically trying to maintain parity with the US dollar. You could theoretically make a stable coin which followed any foreign currency or even a basket of these currencies taking the aggregate value).

[40] *Hot Wallets vs. Cold Wallets*, GEMINI (Mar. 10, 2022), https://www.gemini.com/cryptopedia/crypto-wallets-hot-cold.

[41] *Id*.

[42] *Id*.

[43] Helen Partz, *What Happens if you Lose or Break Your Hardware Crypto Wallet?*, COIN TELEGRAPH (June 14, 2022), https://cointelegraph.com/news/what-happens-if-you-lose-or-break-your-hardware-crypto-wallet.

users of these platforms were subject to. In the absence of concrete regulations, analysis of a two-party contract relationship seems like the most concrete to rely on.[44] Within these user agreements an important split occurs here in the type of user's agreements that existed on Voyager and FTX. While most users were individual investors, a large percentage of the trading volume and overall asset totals kept on these platforms belonged to professional cryptocurrency trading firms.[45] It is unclear if these platforms signed a different agreement. This article considers the public terms of service for each platform and the rules that were set forth to almost all users.[46]

a. The Voyager Approach to Cryptocurrency Ownership

Voyager was a full-service cryptocurrency platform for buying, selling, and trading more than 50 digital asset pairs on its network.[47] Most notably, Voyager offered users who "staked" their own cryptocurrency, a VGX token which generated interest at a rate of 10% per year.[48] Staking or "yield farming" was a popular trend in cryptocurrency where users could put their cryptocurrency to work for them, earning interest on their Bitcoin or Ethereum that would otherwise just be appreciating or depreciating in value.[49] While there exists a lot more sustainable examples of this, the double digit offered by Voyager and Celsius attracted many users.[50] How or what they were doing with their money involved turning over the rights to your cryptocurrency:

> Customer grants Voyager the right, subject to applicable law, without further notice to Customer, to hold Cryptocurrency held in Customer's Account in Voyager's name or in another name, and to pledge, repledge, hypothecate, rehypothecate, sell, lend, stake, arrange for staking, or otherwise transfer or use any amount of such Cryptocurrency, separately or together with other property, with all attendant rights of ownership, and for any period of time and without retaining a like amount of Cryptocurrency, and to use or invest such Cryptocurrency at Customer's sole risk.[51]

Unfortunately for its users, Voyager made a 350-million-dollar loan to 3AC. [52] This loan made up nearly half of their lending business.[53] More than 1.2 billion dollars of crypto, the vast majority

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[44] *See* Feldman v. Google, Inc., 513 F.Supp.2d 229 (E.D.Pa. 2007) (enforcing a "clickwrap" agreement. These are agreements where a user clicks "accept." When these agreements are upheld, they are found to carry the same weight as a signed agreement, regardless if the assenting party read the agreement. However, agreements that are usury or shock conscience may not be upheld) *see also* Specht v. Netscape, 306 F.3d 17 (2d Cir. 2002).
[45] David Curry, *FTX Revenue and Usage Statistics* BUSINESS OF APPS (updated Nov. 16, 2022), https://www.businessofapps.com/data/ftx-statistics/.
[46] It should be noted that either ironically or purposefully all three of these companies had recently made drastic changes to their terms of service. I have been able to find archived versions online and cannot tell what the legal implications of the change would be, as long as their customers were properly notified. The notable change that happened mainly involves the change towards cash deposits on FTX which I explore more in a later section.
[47] Danny Nelson & David Morris, *Behind Voyager's Fall: Crypto Broker Acted Like a Bank, Went Bankrupt*, COINDESK (July 13, 2022, 3:06 PM), https://www.coindesk.com/layer2/2022/07/12/behind-voyagers-fall-crypto-broker-acted-like-a-bank-went-bankrupt/.
[48] *Id*.
[49] *Id*.
[50] *Id*.
[51] Customer Agreement, VOYAGER (updated Jan. 7, 2022), https://www.investvoyager.com/useragreement/.
[52] *Declaration Of Stephen Ehrlich, Chief Executive Officer of The Debtors, In Support of Chapter 11 Petitions and First Day Motions (ECF No. 15, p. 1), In Re Voyager*, Case No. 22-10943 (Bankr. S.D.N.Y. July 6, 2022).
[53] *Id*. at p. 4.

of it owned by users, is now caught up in the bankruptcy.[54] Voyager inadequately addresses this with the following excerpt from their Terms of Use:

> Customer explicitly understands and acknowledges that the treatment of Customer Cryptocurrency in the event of a Customer, Voyager, or Custodian insolvency proceeding is unsettled, not guaranteed, and may result in a number of outcomes that are impossible to predict, including but not limited to Customer being treated as an unsecured creditor and/or the total loss of all Customer Cryptocurrency.[55]

Voyager was bought out of its Chapter 11 restructuring process, and it seemed like the exchange would continue to operate. The purchaser was FTX, a large digital asset platform founded by Sam Bankman-Fried. The bid for FTX was seen as good stability to a cryptocurrency market that had seen several notable names in the industry put into dire straits. A court filing on October 18, 2022, suggested that the acquisition of Voyager by FTX would result in unsecured creditors' (mainly retail investors on the platform) receiving 72% of their crypto holdings back as well as equity in the newly reformed platform and an additional cryptocurrency token, even without Voyager's collecting on the 3AC loan.[56] Approximately one month later, FTX filed for bankruptcy and Voyager needed a new buyer.[57]

b. Voyager and USD

As discussed above, Voyager customers at least agreed to relinquish the title to their digital assets themselves in exchange for interest on their deposits. This concept has been recognized, but its legal consequences have not been ruled on *In Re Voyager Digital Holdings*.[58] The Voyager case has raised the issue of how clients' USD balances should be treated in bankruptcy. Voyager entered into an agreement with a third-party bank to be the custodian of clients' US dollar balances. Voyager's customer agreement states the following:

> Cash deposited into the Customer's Account is maintained in an omnibus account at Metropolitan Commercial Bank (the "Bank"), which is a member of the Federal Deposit Insurance Corporation ("FDIC"). Voyager maintains an agreement with the Bank whereby the Bank provides all services associated with the movement of and holding of USD in connection with the provision of each account. Therefore, each Customer is a customer of the Bank. All U.S. regulatory obligations associated with the movement of, and holding of, USD in connection with each Account are

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[54] *Id*. at p. 11.
[55] Customer Agreement, VOYAGER (updated January 7, 2022), https://www.investvoyager.com/useragreement/.
[56] *Debtors' Omnibus Reply to Objections to APA Motion (ECF No. 558, p. 3-5), In Re Voyager*, Case No. 22-10943 (Bankr. S.D.N.Y. July 6, 2022).
[57] *Certificate Of No Objection Regarding Debtors' Motion For Entry Of An Order (i) Extending The Debtors' Exclusive Periods To File A Chapter 11 Plan And Solicit Acceptances Thereof Pursuant To Section 1121 Of The Bankruptcy Code And (ii) Granting Related Relief (ECF No. 630, p. 1), In Re Voyager*, Case No. 22-10943 (Bankr. S.D.N.Y. July 6, 2022); Soma Biswas, *Bankrupt Voyager Digital Looks for New Buyer After FTX Goes Under*, THE WALL ST. J. (Nov. 11, 2022, 7:35 PM), https://www.wsj.com/articles/bankrupt-voyager-digital-looks-for-new-buyer-after-ftx-goes-under-11668213301.
[58] *In re Voyager Digital Holdings, Inc.,* No. 22-10943 (MEW), 2022 WL 3146796 at *1, *3 (Bankr. S.D.N.Y. Aug. 5, 2022).

> the responsibility of the Bank. For purposes of clarity, any services pertaining to the movement of, and holding of, USD are not provided by Voyager or its Affiliates. Cash in the Account is insured up to $250,000 per depositor by the FDIC in the event the Bank fails if specific insurance deposit requirements are met.[59]

Importantly, the wording of this only ensures the dollars in Metropolitan Commercial Bank *in the event that the Bank fails* and made no guarantees in the event of Voyager failing. Notwithstanding, the Court entered a judgment ruling that the cash held in these accounts were property of the account holders and granting them relief to withdraw their funds. The Court closed with the following thoughts:

> One final word of caution: I am aware that the treatment of cash and cryptocurrency in this and similar cases is a subject of avid interest among investors and insolvency attorneys, and that similar issues may arise in other cases. These chapter 11 cases are somewhat unusual, in that the overwhelming percentage of claims are held by customers, with very few other creditors. As a result, there really were no parties before the Court who had any strong financial interests in disputing the relief sought with respect to the FBO accounts, or in presenting any competing arguments or facts as to how the funds in the FBO accounts should be treated. Other courts who may be presented with similar issues therefore should understand, not only that my decision in this case is based on the agreements that have been presented to the Court, but also that my decision has been rendered without the kind of vigorous opposition by competing creditors that may be present in other cases. This decision is not intended to be a ruling as to the rights that customers might have in cryptocurrency cases generally, or as a ruling on any issues that competing creditors might raise in other cases.[60]

With this word of caution noted, is there anything that we can take from the Voyager bankruptcy and apply to the newly filed FTX case? One distinction jumps out when looking through the two terms of service and particularly how they handled two areas, their crypto and their USD.

c. FTX and Cryptocurrency Ownership

FTX was also a full-service cryptocurrency platform offering services ranging from custody, trading exchange, and NFT marketplace. Larger and better known than Voyager, FTX had over one million users globally.[61] FTX's terms of agreement regarding the ownership of its customers' cryptocurrency differed from Voyager's. This was mainly because their business models differed widely, while Voyager was a cryptocurrency "lending" platform that used your deposits for its lending business, FTX made the majority of its revenue on exchange fees and offered no interest on customer accounts. The FTX terms clearly state:

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[59] Customer Agreement, VOYAGER (updated Jan. 7, 2022), https://www.investvoyager.com/useragreement/.
[60] *In re Voyager Digital Holdings, Inc.,* No. 22-10943 (MEW), 2022 WL 3146796 at *1, *3 (Bankr. S.D.N.Y. Aug. 5, 2022).
[61] David Curry, *FTX Revenue and Usage Statistics*, BUSINESS OF APPS (updated Nov. 16, 2022), https://www.businessofapps.com/data/ftx-statistics/.

> All Digital Assets are held in your Account on the following basis: (A) Title to your Digital Assets shall at all times remain with you and shall not transfer to FTX Trading. As the owner of Digital Assets in your Account, you shall bear all risk of loss of such Digital Assets. FTX Trading shall have no liability for fluctuations in the fiat currency value of Digital Assets held in your Account. (B) None of the Digital Assets in your Account are the property of, or shall or may be loaned to, FTX Trading; FTX Trading does not represent or treat Digital Assets in User's Accounts as belonging to FTX Trading. (C) You control the Digital Assets held in your Account. At any time, subject to outages, downtime, and other applicable policies (including the Terms), you may withdraw your Digital Assets by sending them to a different blockchain address controlled by you or a third party.[62]

These terms on their face offer investors the most protection possible. Similar to the expectation that a parking garage does not own your car simply by the fact you parked it there, FTX's terms of service, on their face, seem to establish no claim to your cryptocurrency. Unlike Voyager and Celsius who generated profits through lending, FTX generated almost 1 billion dollars a year on trading volume on their platform alone, taking a fraction of the 642 billion dollars transacted on their platform in micro-fees on every trade.[63] Statements made in both its terms of service and publicly by its CEO indicated that FTX funds were not traded, lent, or even kept in safe assets such as US treasuries.[64] Without diving into too much speculation, there obviously was something more that was happening with user funds. While all the answers are not clear, it seems that FTX has user liabilities in the billions of dollars backed by a combination of semi liquid-to-illiquid assets that are insufficient to cover its debts, leading it to Chapter 11.[65]

The question then turns to how are clients of FTX going to be treated? There are a few distinct approaches that a court may take to this problem. First, a court may continue to follow the user agreement. As with Celsius and Voyager, the court may look at the agreement that the users entered and determine that the title has always remained with the users, per FTX's terms of service. If the debtor does not have the title to the property, then the property cannot be property of its bankruptcy estate. As a result, it will be removed from the pool of assets used to satisfy creditors and the bankruptcy expenses. This will likely need to take place through an adversary proceeding brought by the customers of FTX. If ownership is not disputed by FTX or another class of creditors, then the crypto would be returned to the customers. It is unclear in FTX's current financial state whether this outcome would result in FTX's clients receiving a pro rata share of the cryptocurrency they held prior to the bankruptcy filings. However, FTX holds billions of dollars in outstanding claims against one of Sam Bankman-Fried's other companies, Alameda Research.[66] Alameda Research

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[62] FTX Terms of Service, FTX (updated May 13, 2022), https://help.ftx.com/hc/article_attachments/9719619779348/FTX_Terms_of_Service.pdf.
[63] Liam Wright, *FTX Trading Volume Surpasses Coinbase in Record Month*, CRYPTOSLATE (June 9, 2022), https://cryptoslate.com/ftx-trading-volume-surpasses-coinbase-in-record-month/.
[64] *Crypto Markets in Turmoil Over FTX Bankruptcy*, REUTERS (Nov. 11, 2022, 7:47 PM), https://www.reuters.com/technology/crypto-markets-turmoil-over-ftx-bankruptcy-2022-11-11/.
[65] *Id*.
[66] *Id.*

is a hedge fund whose role in this is not entirely clear but seems to have gotten a series of loans from FTX raising questions of ethics and liability for both FTX and Alameda leaders.[67]

What if ownership is disputed? What is the best case to be made for a Voyager-like standard? This argument would follow along the lines of custody and the realistic restrictions facing large scale platforms like FTX. While FTX states in its terms of service that you retain all rights to your cryptocurrency, FTX, like almost all other platforms, did not treat your cryptocurrency as if it was your own. Instead, the cryptocurrency was merged into either cold or hot wallets as discussed before. Cryptocurrency is special in that each piece is cryptographically unique.[68] You could, in theory, follow a given cryptocurrency, or even a fraction of cryptocurrency.[69] Likewise, when going to an ATM you do not expect to get the same 20-dollar bill that you deposited out of the machine; could a class of creditors in FTX make the argument that the accounts held by FTX gave it either legal title or an equitable or other beneficial interest in the customers' accounts?

In *Lagemann v. Spence*, the Southern District of New York ruled that investors involved in a pyramid scheme of a reported cryptocurrency investment fund, retained their ownership rights despite the transfer of their cryptocurrency.[70] A plaintiff must also "demonstrate legal ownership or an immediate superior right of possession to a specific identifiable thing."[71] The court continued ruling that despite the funds being transferred voluntarily, the defendant Spence procured the funds through fraud and misrepresentation.[72] Additionally, the investors did not authorize Spence to use their funds in the way that he did. Spence had kept all or a portion of investors' assets after the investors requested their return, despite Spence's lack of any ownership interest in the assets.[73] The finding by the court that Spence lacked any ownership interest in the cryptocurrency that he took from investors bolsters the claims of FTX clients who were deprived of their assets in a manner similar. This would lead to another strong argument that even though users transferred their funds voluntarily, they did not authorize their funds to be utilized by FTX, and instead only entered into a custodial relationship with FTX. The subsequent transferring, lending or theft of clients assets (which is still an unsettled fact in this case) would mean FTX was violating their own terms of service agreement.[74] Comparing FTX to Voyager, the terms of service in Voyager gave Voyager the right to use those deposits to generate interest in any way it saw fit.[75] However, FTX did not retain these controls and remained custodians of users funds but had no title to them.

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[67] Brandy Betz, *FTX Affiliate Alameda Research Loaned $4.1B to Related Parties – Including $1B to Sam Bankman-Fried*, COINDESK (Nov. 17, 2022, 4:34 PM) https://www.coindesk.com/business/2022/11/17/ftx-affiliate-alameda-loaned-41b-to-related-parties-including-1b-to-sam-bankman-fried/.
[68] Jake Frankenfield, *Cryptocurrency Explained With Pros and Cons for Investment*, INVESTOPEDIA (updated Sept. 26, 2022), https://www.investopedia.com/terms/c/cryptocurrency.asp.
[69] *Id*.
[70] *Lagemann v. Spence*, No. 18CIV12218GBDRWL, 2020 WL 5754800, at *1, *10 (S.D.N.Y. May 18, 2020).
[71] *Id*. at *10. (quoting Gateway Overseas, Inc. v. Nishat Ltd., No. 05 Civ. 4260, 2006 WL 2015188, at *7 (S.D.N.Y. July 13, 2006)).
[72] *Id*. at *7.
[73] *Id*.
[74] FTX Terms of Service, FTX (updated May 13, 2022), https://help.ftx.com/hc/article_attachments/9719619779348/FTX_Terms_of_Service.pdf.
[75] Customer Agreement, VOYAGER (updated Jan. 7, 2022), https://www.investvoyager.com/useragreement/.

This should lead to the conclusion that FTX cryptocurrency holders should remain outside of the bankruptcy proceeding.

The Celsius bankruptcy proceeding may give us the first insight into how this cryptocurrency ownership issue may be resolved. Celsius operated as a blend of FTX and Voyager. Celsius had an "Earn" product that operated similarly to Voyager, where they lent out customer assets and in exchange paid interest rates on customers account holdings.[76] In addition, Celsius had a custody product, which did not earn any interest and was used for customers to store their cryptocurrency, similar to FTX.[77] In Celsius' bankruptcy proceeding, customers of the custody product have filed an adversary proceeding alleging that the custody assets, totaling over 200 million dollars, should be outside of the bankruptcy estate.[78] In the debtor's adversary complaint, they rely heavily on the Terms of Service agreement for custody clients, which differed from the language in the "earn" client agreement.[79] Specifically, custody clients entered an agreement stating: "Title to any of your Eligible Digital Assets in a Custody Wallet shall at all times remain with you and not transfer to Celsius."[80] This language is similar to that seen in FTX.[81] The Court has not yet made a ruling on the adversary proceeding with a hearing on this issue set for December 7, 2022.[82]

d. FTX and USD

Keeping the *In Re Voyager* decision and the Voyager agreement terms in mind, we look to the terms set out by FTX on USD. The bankruptcy court's decision *In Re Voyager* relied on the idea that the customers were both clients of the bank and of the cryptocurrency exchange, and therefore, customers' US bank accounts were outside of the scope of the estate. Two sections jump out that differ, first there is no depository bank that FTX was operating through to hold customers the USD deposits. Instead, their terms on fiat currency state the following:

> Once we receive fiat currency that you load into your Account, we may issue you with an equivalent amount of electronic money ("E-Money"), denominated in the relevant fiat currency, which represents the fiat currency that you have loaded. This amount will be displayed in your Account. E-MONEY IS NOT LEGAL TENDER. FTX TRADING IS NOT A DEPOSITORY INSTITUTION AND YOUR E-MONEY IS NOT A DEPOSIT OR INVESTMENT ACCOUNT. YOUR E-MONEY ACCOUNT IS NOT INSURED BY ANY PUBLIC OR PRIVATE DEPOSIT INSURANCE AGENCY. E-Money held in your Account will not earn any interest. Your Account may hold E-Money denominated in different currencies and we will show the E-Money balance for each currency that you hold. You may

[76] *See Complaint For Declaratory Judgement (ECF No. 1, p. 1), Celsius Network LLC, et al. v. Ad Hoc Group of Custodial Account Holders*, Case No. 22-10964 (Bankr. S.D.N.Y. Aug. 31, 2022).
[77] *Id*.
[78] *Id*.
[79] *Id*.
[80] *Id*.
[81] FTX Terms of Service, FTX (updated May 13, 2022), https://help.ftx.com/hc/article_attachments/9719619779348/FTX_Terms_of_Service.pdf.
[82] *See Joint Stipulation And Agreed Scheduling Order By And Among The Debtors, The Committee, And The Ad Hoc Groups With Respect To The Custody And Withhold Issues (ECF No. 12, p. 6), Celsius Network LLC, et al. v. Ad Hoc Group of Custodial Account Holders*, Case No. 22-10964 (Bankr. S.D.N.Y. Aug. 31, 2022).
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> purchase Digital Assets by using E-Money credited to your Account (depending on your location). To carry out a Digital Asset purchase using E-Money, you must follow the relevant instructions on the Site. You authorize us to debit E-Money from your Account to complete your purchase. Although we will attempt to deliver Digital Assets to you as promptly as possible, E-Money may be debited from your Account before Digital Assets are delivered to your Account.[83]

It is interesting to note that while the rights of those holding cryptocurrency on FTX were higher than those on Voyager, their rights for users to their USD seem significantly worse. Like a credit union or local bank that may not have FDIC insurance, FTX users who had their balances in USD, or what FTX calls "E-MONEY," should be considered unsecured creditors in this case. The terms of E-MONEY provide no information about users' rights to the money in their accounts. In the absence of this information, courts will likely view USD deposits at FTX and their subsequent conversion to E-MONEY as unsecured creditors. This puts FTX holders with "E-MONEY" frozen in their accounts and FTX cryptocurrency holders with their assets frozen in their accounts at odds with each other. Additionally, a single user may belong to both committees of creditors separately, as it is not uncommon for an investor to have a balance of both USD and cryptocurrency in their trading account.

Conclusion

FTX, Voyager, and Celsius all present cases of first impression for US Bankruptcy Courts. The correct outcome in these cases is absent guiding statutory language; the court should look to what users agreed to through the terms of service when they began using each platform.

In the case of Voyager, customers' USD balance is outside of the bankruptcy estate and will be returned to them, while their cryptocurrency will remain part of the bankruptcy estate and Voyager cryptocurrency holders will make up the unsecured creditors class. In FTX, the opposite is true. The customers' USD balance, as outlined in FTX's terms and conditions, is unsecured "E-MONEY" credits, and customers with a USD balance shall make up the unsecured creditors class. However, their cryptocurrency balance will be outside of the bankruptcy, as they have retained either complete or beneficial title. This creates an interesting dynamic where the creditors class of FTX may not have any money left in the estate by the time FTX users have their funds returned to them. A majority of the assets on FTX, which are now missing, were cryptocurrency.

A key tenant of bankruptcy law is not discussed in this article: the process of maximizing the value of the FTX estate through avoidance actions, notably preference payments and fraudulent transfers. This will be discussed further in a follow-up publication to this article. While I remained as accurate as possible throughout this post, this topic has been difficult to write on as it is a fast-changing legal environment with even faster changing set of facts. As anyone who has gotten to this point can tell, I did not go into the speculative nature of how FTX became insolvent and instead focused solely on the bankruptcy and how that may proceed.

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[83] FTX Terms of Service, FTX (updated May 13, 2022), https://help.ftx.com/hc/article_attachments/9719619779348/FTX_Terms_of_Service.pdf.

FTX, Voyager, and Celsius are laying important groundwork, with none of the cases successfully navigating out of Chapter 11 bankruptcy to date. The precedent set in these cases is a first for the bankruptcy industry and a field that will undoubtedly see continued growth. While FTX, Voyager, and Celsius were the first of these kinds of bankruptcies, they are certainly not the last that the bankruptcy court will have to contend with.

Thank you for taking the time to read this. If you have any feedback, criticism, or corrections, please direct them to jjenglish@widener.edu.