

# Bankruptcy & Restructuring Solutions to the Crypto Crisis

The financial news has been dominated recently by a series of high-profile crypto failures and bankruptcies and its making investors edgy. [Allan Nackan](#) explains the turmoil faced by many crypto exchanges around the world and offers restructuring and bankruptcy solutions to help exchanges and investors deal with the evolving challenges.

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The crypto winter is upon us... Bitcoin (BTC) and other cryptocurrencies have recently been in free fall and high-profile bankruptcy filings of major crypto exchanges and lenders such as Three Arrows Capital (3AC), Voyager Digital, and Celsius Networks are making investors edgy.

## Lehman moment

Some are even viewing the recent US Chapter 11 filing of Celsius Networks as a "*Lehman Brothers moment*" for the crypto industry. This reference to the fall of Lehman Bros. draws parallels to the massive failure of Lehman that dominated the 2008 global financial crisis, along with failures of other financial institutions such as Bear Stearns and Merrill Lynch. It is not hard to see why parallels are being drawn due to the inter-connectedness of recent events, which raises concerns about other crypto exchanges failing and threats of contagion mount.

## Domino effect

Bitcoin and other cryptocurrencies were riding high. Then, in May 2022 the currency called Luna plunged, which had an unexpected and adverse impact on TerraUSD (UST), an algorithmic stablecoin that was pegged to Luna. This event was likely a catalyst for 3AC's insolvency and the domino effect that followed.

Three Arrows Capital, a crypto hedge fund, was placed into liquidation in British Virgin Islands, with recognition proceedings under Chapter 15 in USA and also in Singapore. Hot on the heels of this news, an exchange called Voyager Digital was forced into filing for Chapter 11 protection in USA due to its \$670 million exposure to 3AC. The recoverability of amounts

from 3AC is questionable and, as a minimum, will be delayed by 3AC's liquidation proceedings, which creates liquidity issues for Voyager. A restructuring plan is being worked on that will potentially see Voyager customers receiving part cash, part crypto, and participation in any recovery from 3AC.

Voyager also sought recognition of its Chapter 11 proceedings under Part IV of CCAA (Canadian equivalent of Chapter 15). The Canadian courts recognized the US proceeding and extended the stay of proceedings to Canada. This was done over the opposition of certain class action litigants who were questioning whether the US proceedings were a "foreign main proceeding" or not. This foreshadows some of the complexities that will arise in dealing with crypto exchanges which operate across multiple jurisdictions.

Soon thereafter, Celcius Network, a large US-based crypto lender, which initially froze withdrawals, then filed for Chapter 11 in USA. Other exchanges such as crypto lender, Vault, also froze withdrawals, trading and deposits. Later they obtained a moratorium in Singapore to prevent liquidation and other actions against it. Other casualties are unfolding and more are likely – particularly if Bitcoin and other crypto prices continue to fall and investor confidence wanes.

## Whose crypto is it?

The burning question on investors minds is, who actually owns the crypto traded through these platforms? Are these assets held in custodial accounts for the benefit of the holders or will they be treated as assets of the exchange which were commingled with its other assets? The answer lies in the fine print of customer user-agreements and conduct of the parties and will most likely be the subject of priorities disputes that will be tested in the courts. Unfortunately, many investors may find themselves in the category of unsecured creditors, having to compete with other general creditors for their *pro rata* share of the net recoveries in a bankruptcy proceeding. In cases like 3AC where a potential shortfall of more than \$1.2 billion has been exposed, investors could suffer substantial losses. Further, there may be significant delays in receiving distributions as these cases work their way through the courts in multiple jurisdictions and many complex issues get dealt with, including efforts to recover the underlying crypto assets, identify and resolve claims and priorities, and prosecute legal claims.

With few precedents to follow, we will be in uncharted territory due to the unique characteristics of these digital assets. That said, the path to resolving these cases is not dissimilar to the brokerage firms, investment frauds and Ponzi schemes that insolvency professionals like us are accustomed to dealing with.

## Enhanced tools for recovery and resolution

While, "Bankruptcy" and "Restructuring" are words no investor wants to hear, there are potential benefits that flow from the structured approach of court-supervised insolvency proceedings, including:

- an immediate stay of proceedings comes into effect – from the exchange’s perspective, this halts the very real risk of a “run on the bank” and allows time for the company and its advisors to stabilize the situation and formulate a restructuring plan. For investors, it puts everyone on an even footing and avoids a free-for-all that favours some creditors over others
- use of Chapter 11 in the USA and [Companies Creditors Arrangement Act \(CCAA\)](#) in Canada can provide an effective platform for dealing with complex multi-party disputes and voluminous claims. Use of a restructuring plan can help facilitate a favourable resolution of claims against directors & officers, insurers and other 3<sup>rd</sup> parties, in exchange for valuable 3<sup>rd</sup> party releases
- liquidation and restructuring proceedings allow for an orderly disposition of the assets, which may include a sale of the business, transitioning of customer accounts into the safe hands of a new custodian, and attracting essential rescue financing (commonly known as DIP financing) to deal with short term liquidity challenges and to fund the restructuring efforts
- the downside of these proceedings is that they can be costly and can result in lengthy delays in distributions to creditors and investors, as has happened in the Lehman Bros. and Mt. Gox cases. That said, stakeholders get the benefit of experienced judges, restructuring lawyers and financial advisors taking control and guiding the case to a best outcome and providing necessary stewardship
- there is scope within CCAA and Chapter 11 proceedings for investors to come together in groups or committees, which can be jointly represented by legal counsel and financial advisors. This gives the group an effective and enhanced “voice” in the proceedings, and provides access to sound legal and financial advice, which costs can be shared and sometimes even paid out of the estate
- as insolvency practitioners and forensic accountants, we have a powerful toolkit of statutory and other court-ordered remedies that allow us to examine company records; trace and recover assets internationally and across borders; freeze assets by way of Mareva injunctions; compel disclosure and cooperation from parties, such as auditors, bankers, web service providers etc. This allows us to effectively identify, trace and recover assets that would otherwise be lost. This is especially the case when dealing with crypto assets which can be moved instantly with a keystroke
- finally, unusual and fraudulent transactions that occurred in the run-up to insolvency, can be set aside or challenged using bankruptcy and other statutes. This results in potential additional sources of recovery for investors, particularly where fraud or malfeasance has occurred

## Novel challenges and features

The unique characteristics of crypto assets present their own challenges, including:

- many crypto exchanges and other platforms are currently unregulated, resulting in investors being exposed to unexpected and unsuitable risks, and without the rigour of regulation and the backstop provided by deposit

guarantees

- it is crucial for insolvency practitioners to promptly gain access and secure the private keys, without which crypto assets will be inaccessible or even disappear. The most startling example of this is the Canadian crypto exchange called Quadriga, whose founder died suddenly on a trip to India, leaving no one with his private key to access \$180M of crypto and leaving about 115,000 customers stranded
- an interesting characteristic of cryptocurrencies such as Bitcoin is that they are pseudonymous. Every Bitcoin is tied to the address on the blockchain in which it is received. Transactions are stored forever in the blockchain, and tech savvy investigators can view all transactions, which if linked to an individual, can identify every transaction ever associated with them

Crypto cases will present many novel issues for insolvency practitioners, judges and lawyers to work through, whether acting for the crypto exchange/lenders themselves or on behalf of investors. We are closely monitoring developments and cases around the globe. Feel free to reach out to [Allan Nackan](#) for more information.

## Debunking Five Fallacies About Financial Distress

We dispel some common restructuring myths and helps business owners learn their options. [Get the insight.](#)

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### Our Contributors

*[Allan Nackan](#) is a Senior Managing Director at GlassRatner and co-leads the firm's Restructuring practice. His practice focuses on corporate insolvency and restructuring, financial advisory services, cross-border restructuring, fraud investigations, and forensic accounting. Allan can be reached at [anackan@glassratner.com](mailto:anackan@glassratner.com) or at 437.294.4602*

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