

CARRY ON KEEPING CALM - A REVIEW OF THE RECENT DEVELOPMENTS IN THE CRYPTO ASSET WORLD

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In our previous article from June 2022, *Keep Calm and Carry On - Unpicking Crypto Relationships In Any Insolvency*, we discussed developments in the crypto market, the meaning of crypto assets and how insolvency practitioners and their advisors identify the owner of crypto assets on insolvency. In this follow up article we will explore how the crypto-sphere has advanced since the previous article, revisit some of the predictions we made and identify key updates in the crypto market and what those updates mean for the insolvency world.

Those well-versed with the crypto world will know that what we (and the wider crypto sector) referred to as the “winter of discontent” back in June 2022 proved to be exactly that and then some. At the time of writing there were some palpable insolvency concerns around Celsius Network as well as Three Arrows Capital (3AC). What has ensued in the 18 months since then was beyond predictable, with 3AC ordered to liquidate by a British Virgin Islands Court in June 2022, Celsius and Voyager filing for Chapter 11 Bankruptcy in July 2022 as well as the shockwave-inducing collapse of FTX in November 2022.

A simple explanation as to the cause of the above crashes could be attributed to Bitcoin’s brutal crash from its all-time high value of \$68,000 to below \$20,000 in June 2022. However, applying such an explanation would be reductionist to say the least. Indeed, various other factors such as the overleveraged position of key players within the industry, the market sentiment and widespread euphoria within the crypto bubble (and the opposite when the bubble popped) and the well-documented fraudulent actions of notable individuals (see Sam Bankman-Fried) cannot be ignored for the roles that they have played. Regardless of the cause, the effect has been misery to millions, with the “winter of discontent” wiping out \$2 trillion (yes, with a T) worth of value from the total crypto market.



As ever though, the saying “every cloud has a silver lining” rings true. Whilst the above, and the general downtrend prevalent in crypto over the last eighteen months, may not have turned a profit on investment, the various collapses have meant that Courts across the world have (finally) been able to consider numerous legal points surrounding cryptocurrencies. The increased and well-publicised market turmoil has also prompted various governments and regulators to step in and create a regulatory framework for the “new asset on the block”.

“Crypto is property”

We discussed in our previous article that the Courts have shown a great degree of flexibility when considering crypto-related issues, including the several cases in English Courts where cryptocurrency has been recognised as property. This point was affirmed by the Southern District of New York’s Bankruptcy court, in considering the bankruptcy of Celsius. The New York court also aptly demonstrated its flexibility by ruling that the assets held by Celsius in “custody” accounts belonged to customers and those held in “interest-bearing” accounts belonged to Celsius, a finding which resulted in the Court approving a refund of \$297 million in BlockFi’s bankruptcy a few months later.

The distinction made by the New York Court concurs with how we predicted Courts would operate when analysing insolvency exchanges, by reviewing both the written terms and conditions as well as the day-to-day business practice. In turn, this provides a useful mechanism for Insolvency Practitioners to use in characterising crypto assets when dealing with an insolvent company (whether that be an exchange or a customer of an exchange). By determining where title to a crypto asset is vested, Insolvency Practitioners can either concede ownership without expending significant time and cost or embark on recovering the asset, noting first and foremost that crypto assets are just that: assets.



We also previously posed the question whether crypto assets were held on trust, and whilst this hasn't been considered by the English and Welsh Courts to date, Hong Kong's High Court held in the case of Gatecoin Limited (in administration), by reference to judgments from seven other legal jurisdictions, that crypto assets are capable of being held on trust. Perhaps it makes sense that when considering crypto asset-related insolvency issues, practitioners consider findings of Courts from other jurisdictions given the global nature of crypto assets and the lack of cases being heard in the English and Welsh Courts.

(Judgment: <https://www.hklii.org/en/cases/hkcfi/2023/914>)

Law Commission's consultation on "Digital Assets"

As briefly touched upon already, the "Crypto Winter" allowed governments and regulators around the world an opportunity to step in and construct regulatory framework around crypto assets. Whilst that might be worrying for those empowered by the notion of crypto assets being free from centralisation, regulation and governmental oversight, it also sends a positive message for the crypto market, and that is that crypto is here to stay.

In so far as Insolvency Practitioners (and their legal advisers) are concerned, the above means that it is time to start paying attention to crypto assets if you haven't been doing so already. With the next BTC halving predicted to take place in Q1 of 2024 and the resulting "Bull Market" poised to take off imminently it is only a matter of time before crypto becomes all the rage again. However, as we saw in 2022, downtrends follow market euphoria and based on the crypto market's cyclical and exponential nature, future collapses could be more widespread (and potentially bigger) than ever before. It is therefore of increased importance that insolvency practitioners (and their advisers) verse themselves well in the direction of legal and regulatory developments in the sector.

One key development which has already garnered attention is the Law Commission's consultation paper on "Digital Assets" which was published shortly after our previous article in 2022. Following the consultation period, the Law Commission issued its report to the UK Government making recommendations to reform UK law such that it is capable of accommodating crypto assets (as well as other digital assets).



The Law Commission's final report presented a tripartite approach to law reform, comprising the following key principles:

1. Prioritising common law development – this is based on the conclusion that the common law of England and Wales is, generally, sufficiently flexible and already able to accommodate digital assets without an arduous upheaval exercise as would be required for generic statutory reform;

2. Targeted statutory law reform – presented direct and implementable recommendations that confirm and support existing and new common law positions; and

3. Support from industry-specific technical experts – identifying that it would be an enormous ask of the judiciary, on its own devices, to remain alive to technological advances without the assistance of industry-specific technical experts, legal practitioners and academics.

One of the Law Commission's key recommendations to the Government is the introduction of a "third" category of personal property, which follows the Law Commission's conclusion that digital assets are neither things in possession nor things in action.

Whilst it is unclear how the Government proposes to implement the Law Commission's recommendations (if at all), we can expect that the law will have advanced significantly ahead of any future "Crypto Winter", if not by reference to statute, then certainly by reference to case law, which has flowed from the demise of Celsius, FTX and the like.



To conclude, whilst there have been various developments over the last 18 months worthy of note, the position for Insolvency Practitioners remains largely as it was. When unpicking a legal relationship based on crypto assets, remember that the analysis required is (at least for the time being) no different from the analysis required for any other asset class. It is still imperative that practitioners take steps to understand the technology, terminology and legal developments in the sector. If that's something you're already doing then Keep Calm and Carry On.



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