

# Clients & Friends Memo

## Quantifying Cryptocurrency Claims in Bankruptcy: Does the Dollar Still Reign Supreme?

December 7, 2022

In the past six months, four major players in the crypto space have filed for chapter 11 bankruptcy protection: Celsius Network, Voyager Digital, FTX, and BlockFi, and more may be forthcoming. Together, the debtors in these four bankruptcy cases are beholden to hundreds of thousands of creditors. The bulk of the claims in these cases are customer claims related to cryptocurrency held on the debtors' respective platforms. These customer claimants deposited or "stored" fiat currency and cryptocurrencies on the debtors' platforms. Some of these funds allegedly were commingled or rehypothecated, leaving customer accounts severely underfunded when liquidity crunches arose at the various entities. The total amount of such claims is estimated to be in the billions — that is, if these claims ultimately are measured in United States Dollars ("USD").

Crypto-watchers and bankruptcy lawyers alike have speculated how customer claims based on digital assets such as cryptocurrencies should be valued and measured under bankruptcy law. Given the volatility of cryptocurrency prices, this determination may have a significant effect on recoveries, as well as the viability of the "payment-in-kind" distribution mechanics proposed in Voyager, Celsius, and BlockFi. A number of creditors appearing *pro se* in these proceedings have expressed a desire to keep their mix of cryptocurrencies through these proposed "in-kind" distributions.

However, a crypto-centric approach to valuing claims and making distributions raises a number of issues for consideration. For example, measuring customer claims in cryptocurrency and making "in-kind" distributions of these assets could lead to creditors within the same class receiving recoveries of disparate USD value as the result of the fluctuation in cryptocurrency prices. Moreover, as has been discussed in the Celsius proceedings, the administrative burden associated with maintaining, accounting for, and distributing a wide variety of cryptocurrencies as part of a recovery scheme would likely prove complex. Equity holders also might challenge the confirmability of a plan where valuations and recoveries are based on cryptocurrency rather than USD, as a dramatic rise in cryptocurrency values could return some value to equity.

Like most issues at the intersection of insolvency and cryptocurrency, there is little precedent to guide creditors through the uncertainties, but a recent dispute in the Celsius bankruptcy proceedings as to whether a debtor is required to schedule claims in USD, or whether cryptocurrency claims can be scheduled “in-kind,” may serve as a preview of things to come.

## I. General Background

Celsius Network (“**Celsius**” and, together with its affiliated debtors and debtors in possession, the “**Debtors**”), self-described as one of the “largest and most sophisticated” cryptocurrency-based finance platforms and lenders that claimed over 1.7 million users worldwide,<sup>1</sup> filed petitions under Chapter 11 of the Bankruptcy Code on July 13, 2022.<sup>2</sup> On October 5, 2022, the Debtors filed their schedules of assets and liabilities (“**Schedules**”). Each Debtor’s schedule of unsecured creditors’ claims (Schedule E/F) lists the claims of the Debtors’ customers by the number of various forms of cryptocurrency coins and account types, rather than in USD.<sup>3</sup>

On October 25, 2022, a group of beneficial holders, investment advisors, and managers of beneficial holders (collectively, the “**Series B Preferred Holders**”) of the Series B Preferred Shares issued by debtor Celsius Network Limited filed a motion seeking entry of an order directing the Debtors to amend their Schedules to reflect customer claims valued in USD, in addition to cryptocurrency coin counts.<sup>4</sup>

## II. Arguments

### a. Series B Preferred Holders

Broadly, pursuant to Bankruptcy Rule 1009(a),<sup>5</sup> the Series B Preferred Holders sought to have the Debtors amend their Schedule E/F to “dollarize” creditors’ claims, *i.e.*, value customer claims in their dollar value as of the petition date. As filed, the Series B Preferred Holders asserted that the Debtors’ schedules were “improper, misleading, and fail[ed] to comply” with the Bankruptcy Rules “because they schedule[d] customer claims in cryptocurrency coin counts, rather than in lawful

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<sup>1</sup> Declaration of Alex Mashinsky, CEO of the Debtors ¶¶ 1, 9, 20, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 23].

<sup>2</sup> *Id.* at ¶ 131.

<sup>3</sup> Debtors’ Schedules of Assets and Liabilities and Statements of Financial Affairs, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 974]; see also Schedule E/F, Case No. 22-10967 [Docket No. 5]; Case No. 22-10970 [Docket No. 5]; Case No. 22-10968 [Docket No. 5]; Case No. 22-10965 [Docket No. 6]; Case No. 22-10966 [Docket No. 7]; Case No. 22-10964 [Docket No. 974]; Case No. 22-10969 [Docket No. 5]; Case No. 22-10971 [Docket No. 5].

<sup>4</sup> Series B Preferred Holders Motion to Direct Debtors to Amend Schedules, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 1183].

<sup>5</sup> “On motion of a party in interest, after notice and a hearing, the court may order any . . . schedule . . . to be amended and the clerk shall give notice of the amendment to entities designated by the court.” Fed. R. Bankr. P. 1009(a).

currency of the United States as of the Petition Date.”<sup>6</sup> The Series B Preferred Holders asserted that such amended schedules are essential to the Debtors’ ability to structure, solicit, and confirm a plan of reorganization under the requirements of Section 1129, including whether “(i) claims are impaired or unimpaired, (ii) holders of similarly situated claims are receiving the same treatment, and (iii) the plan meets the requirements of the ‘absolute priority rule.’”<sup>7</sup> In support of their arguments that USD valuation of a customer’s claim should be required, the Series B Preferred Holders relied on provisions of the Bankruptcy Rules, Bankruptcy Code, and Official Forms. The Series B Preferred Holders stressed that the motion “takes no position regarding the form of distribution customers” should receive under the Debtors’ plan, but rather that the Debtors must “add the [USD] amount of each customer claim in Schedules E/F to the cryptocurrency coin counts.”<sup>8</sup>

The Series B Preferred Holders also asserted that the requirement to denominate claims in USD is consistent with Section 502(b) of the Bankruptcy Code, which provides that when a debtor or party-in-interest objects to a claim, the court determines the amount of the claim in USD as of the debtor’s petition date.

#### **b. Debtors’ Response**

The Debtors had previously indicated that they were not seeking to dollarize its customers’ claims; rather, the Debtors represented that they intend to return cryptocurrency assets to its customers “in kind.”<sup>9</sup> The Debtors stated that they interpreted Bankruptcy Rule 9009(a)(1)-(2) and General Order M-386, dated November 24, 2009 (the “**General Order M-386**”) to allow the Debtors to remove the dollar symbol when scheduling claims regarding cryptocurrency coin counts.<sup>10</sup> This approach, the Debtors argue, lessens confusion for its customer case and decreases administrative expense for the estate.<sup>11</sup>

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<sup>6</sup> Series B Preferred Holders Motion to Direct Debtors to Amend Schedules ¶ 1.

<sup>7</sup> *Id.* ¶ 3 (citing 11 U.S.C. §§ 1123(a)(2)-(4), 1129(a)(1), 1129(b)).

<sup>8</sup> Series B Preferred Holders’ Reply ¶ 10, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 1334].

<sup>9</sup> See 8/16/22 Hr’g Tr. at 35:5-7 (“The company is not seeking to dollarize claims on the petition date and give people back a recovery in fiat.”); *id.* at 42:11-16 (“[The UCC is] pleased that the company is not focused on dollarization of claims . . . an in-kind recovery is absolutely critical.”).

<sup>10</sup> General Order M-386 is a resolution of the Board of Judges for the Southern District of New York, which provides for “a standard form for orders to establish deadlines for the filing of proofs of claim . . . in chapter 11 cases” to “thereby expedite court review and entry of such orders.”

<sup>11</sup> Debtors’ Objection to Series B Preferred Holders’ Motion ¶ 9, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 1304].

Further, the Debtors argued that the Series B Preferred Holders' reliance on Section 502(b) was misplaced because the application of such section is inapplicable at this stage of the proceedings where no claims objection has taken place.<sup>12</sup>

The Committee of Unsecured Creditors ("**UCC**") agreed with the Debtors' approach, stating that it "makes sense" for account holders to validate their scheduled claims by cryptocurrency type and that it wished to be consulted on the petition date prices used by the Debtors if they filed an amendment to the schedules.<sup>13</sup>

### III. Analysis

#### a. Bankruptcy Code & Rules & Forms

Bankruptcy Rule 1007(b)(1) requires that a debtor's schedules of assets and liabilities must be "prepared as prescribed by the appropriate Official Forms."<sup>14</sup> The relevant official form that a debtor must use to prepare its schedule of assets and liabilities is Official Form 206, which contains a USD symbol to denote the amount of liabilities that a debtor must list.<sup>15</sup> Specifically, Official Form 206 provides:

Part 2: Summary of Liabilities	
2. <b>Schedule D: Creditors Who Have Claims Secured by Property</b> (Official Form 206D) Copy the total dollar amount listed in Column A, <i>Amount of claim</i> , from line 3 of <i>Schedule D</i> .....	\$ _____
3. <b>Schedule E/F: Creditors Who Have Unsecured Claims</b> (Official Form 206E/F)	
3a. <b>Total claim amounts of priority unsecured claims:</b> Copy the total claims from Part 1 from line 5a of <i>Schedule E/F</i> .....	\$ _____
3b. <b>Total amount of claims of nonpriority amount of unsecured claims:</b> Copy the total of the amount of claims from Part 2 from line 5b of <i>Schedule E/F</i> .....	+ \$ _____
4. <b>Total liabilities</b> ..... Lines 2 + 3a + 3b	\$ _____

As seen above, Official Form 206 does "hardwire" a dollar sign ("\$") into the boxes provided for claim amounts. Bankruptcy Rule 9009 states that the official forms are to "be used without alteration, except as otherwise provided in the rules, [or] in a particular Official Form."<sup>16</sup> Bankruptcy

<sup>12</sup> *Id.* ¶ 12 (citing *In re Mohr*, 425 B.R. 457, 464 (Bankr. S.D. Ohio)).

<sup>13</sup> *Id.* at 42:12-16 ("We are pleased to hear that the company is not focused on dollarization of claims . . . receiving an in-kind recover is 16 absolutely critical."); UCC Statement and Reservation of Rights ¶ 6, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 1303].

<sup>14</sup> Fed. R. Bankr. P. 1007(b)(1).

<sup>15</sup> See Official Form 206, Part 2, Line 4 (using the USD sign into Form 206 for scheduling the debtor's liabilities).

<sup>16</sup> Fed. R. Bankr. P. 9009(a).

Rule 9009 permits “certain minor changes not affecting wording or the order of presenting information,” including “expand[ing] the prescribed areas for responses in order to permit complete responses” and “delet[ing] space not needed for responses.”<sup>17</sup> Lastly, General Order M-386 permits “such revisions as are necessary under the circumstances of the individual case or cases.”<sup>18</sup> The introduction to General Order M-386 states that standard forms were adopted to “expedite court review and entry of such orders” and that courts will expect use of the standard forms “with only such revisions as are necessary under the circumstances of the individual case or cases.”<sup>19</sup>

**b. Section 502(b)**

Bankruptcy Code Section 502(b) provides that if there is an objection to a claim, the court “shall determine the amount of such claim in lawful currency of the United States as of the [petition] date . . . .”<sup>20</sup> This “prevents the value of a claim from fluctuating by setting the claim as of the petition date and converting it to the United States dollars.”<sup>21</sup> Acknowledging the “novel phenomenon” of dollarizing claims in cryptocurrency, the Series B Preferred Holders analogize this to cases where courts have required claims asserted in or based on in foreign currency or amounts of gold should be valued in USD. However, these cases were decided in the context of a claims objection. The Celsius Debtors argued that these cases have limited utility in the context of a motion for an order directing the Debtors to amend their schedules pursuant to Bankruptcy Rule 1009(a).<sup>22</sup>

**IV. The Court’s Order**

Ahead of the hearing regarding the motion for an order directing the Debtors to amend their schedules, the Debtors and the Series B Preferred Holders were able to consensually resolve the motion and filed a revised proposed order prior to the hearing on the motions on November 15.<sup>23</sup> The Debtors agreed to amend their schedules by filing a conversion table within three days of the

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<sup>17</sup> *Id.*

<sup>18</sup> General Order M-386 ¶ 9.

<sup>19</sup> General Order M-386 ¶ 2 (unnumbered, preliminary statement).

<sup>20</sup> 11 U.S.C. § 502(b).

<sup>21</sup> *In re Aaura, Inc.*, No. 06 B 01853, 2006 WL 2568048, at \*4, n.5 (Bankr. N.D. Ill. Sept. 1, 2006).

<sup>22</sup> *In re USGen New Eng., Inc.*, 429 B.R. 437, 492 (Bankr. D. Md. 2010) (using the exchange rate in effect on the petition date, in the context of a claims objection, to convert the claim to USD), *aff’d sub nom. TransCanada Pipelines Ltd. v. USGen New Eng., Inc.*, 458 B.R. 195 (D. Md. 2011); *Aaura*, 2006 WL 2568048, at \*5 (“Section 502(b) converts Aaura’s obligation to repay the obligation in gold into a claim against the estate in dollars, but it makes this transformation only as of the petition date, not retroactive to the date on which Aaura first became liable.”); *Matter of Axona Intern. Credit & Com. Ltd.*, 88 B.R. 597, 608 n.19 (Bankr. S.D.N.Y. 1988) (noting Section 502(b) refers to the petition date as “the appropriate date for conversion of foreign currency claims”), *aff’d sub nom. In re Axona Intern. Credit & Com. Ltd.*, 115 B.R. 442 (S.D.N.Y. 1990); *ABC Dev. Learning Ctrs. (USA), Inc. v. RCS Capital Dev., LLC (In re RCS Capital Dev., LLC)*, No. AZ-12-1381-JuTaAh, 2013 Bankr. LEXIS 4666, at \*38-39 (B.A.P. 9th Cir. July 16, 2013) (same).

<sup>23</sup> Notice of Proposed Order, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 1342].

entry of the order, in consultation with the UCC and Series B Preferred Holders, that reflects the Debtors' view of the rate of conversion of all cryptocurrencies listed in the Debtors' schedules to USD as of the petition date. The idea is that the conversion table could be used by customers as a reference for calculating the USD value of their claim, to the extent needed for filing a proof of claim. The conversion table is not binding – the order preserves the rights of all parties to contest the conversion rates and does not require a party-in-interest to file an objection that is not stated in USD “solely on the basis that such claims should be reflected in [USD].”<sup>24</sup> The order also requires the Debtors to file updated schedules “dollarizing” its account holders' cryptocurrency holdings to the extent required by any future court order or judicial determination.

On November 17, 2022, the court entered the revised proposed order.<sup>25</sup>

## V. Cash Is Still King?

Other bankruptcy courts have taken similar approaches as the *Celsius* court in this issue. An earlier cryptocurrency case, *In re Cred Inc.*, the debtors did not schedule cryptocurrency claims in USD, but included a conversion table in their filed schedules, which set forth a conversion rate to USD as of the petition date.<sup>26</sup> Debtors in other cases, such as *Voyager Digital*, scheduled the amounts of their customer claims as “undetermined” and listed them in Schedule F in cryptocurrency.<sup>27</sup> BlockFi, which filed for bankruptcy on November 28, 2022, already has filed a proposed plan that would distribute its cryptocurrencies to its customers in-kind in exchange for their claims against the BlockFi debtors.<sup>28</sup> To date, neither BlockFi nor FTX have filed their schedules, and it remains to be seen whether they will follow the pattern established in *Celsius* and *Voyager*.

For creditors and equity holders, whether claims are measured in USD or the applicable cryptocurrency is only the beginning of what will likely be a long and contentious road to recovery. It remains to be seen whether any of these debtors will be able to confirm a viable restructuring plan that relies on any sort of “in-kind” distribution of cryptocurrencies. Further issues are likely to arise in the claims resolution process even further down the road as claimants and liquidation trustees (or plan administrators) wrestle with how to value claims based on such a volatile asset, subject to ever-increasing regulatory scrutiny. However, for the time being, the bankruptcy process continues to run on USD.

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<sup>24</sup> *Id.* at ¶¶ 7, 8.

<sup>25</sup> Order Pursuant to Bankruptcy Rule 1099 Directing the Debtors to Amend Their Schedules in Certain Circumstances, *In re Celsius Network LLC*, Case No. 22-10964 (MG) (Bankr. S.D.N.Y. 2022) [ECF No. 1387].

<sup>26</sup> Schedules at 12, *In re Cred Inc.*, Case No. 20-128336 (JTD) (Bankr. D. Del. 2021) [ECF No. 443].

<sup>27</sup> Schedules, *In re Voyager Digital Holdings, Inc.*, Case No. 22-10943 (MEW) (Bankr. S.D.N.Y. Aug. 18, 2022) [ECF No. 311].

<sup>28</sup> Joint Plan of Reorganization § IV.B.1.a, *In re BlockFi Inc.*, Case No. 19361 (MBK) (Bankr. D.N.J. 2022) [ECF No. 22].

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