

Novel issues facing Cayman insolvency professionals dealing with crypto assets

Conyers' Paul Smith, Róisín Liddy-Murphy and Jordan McErlean discuss

This year marked the tenth anniversary of the world's first cryptocurrency, Bitcoin. Cryptocurrency emerged as a by-product of digital cash with the goal of creating a decentralised currency, which would allow users to anonymously transfer funds online without restriction. Despite its overwhelming success, the crypto market is still very much in its adolescence with little regulatory governance. This article provides an overview of some of the challenges facing Cayman insolvency professionals (IPs) when confronted with insolvent estates possessing crypto assets¹.

IDENTIFYING, REALISING AND CONTROLLING CRYPTO ASSETS

Identifying and obtaining control over crypto assets

It is important for IPs to understand how to deal with a crypto asset as the primary duty of an IP is to maximise the value of assets for the benefit of creditors. The first difficulty an IP will face will be to identify and obtain control of the crypto asset from the individual(s) in possession of the private key for the digital wallet. Crypto assets are typically held in a digital wallet, which can usually only be accessed through a private key. Without the private key, IPs will not be able to access the crypto assets in order to exercise control or realise their value. In most situations, IPs will therefore require the co-operation of an individual closely associated with the insolvent estate, such as a director or investment manager to access the wallet. The task of identifying the holder of the key will likely involve some investigation since the holder of the digital wallet is not always required to disclose their personal information and will often use pseudonyms. The importance of adequately protecting and securing control over a wallet was demonstrated by the high-profile insolvency of Canada's biggest cryptocurrency exchange, QuadrigaCX. In that case, due to the untimely death of the exchange's chief executive Gerald Cotten, approximately US\$142m in Bitcoin and other cryptocurrency were locked in offline wallets that are inaccessible since Cotten had sole possession of the pass codes.

Realising and distributing crypto assets

Where an IP gains control over the crypto asset, the next hurdle is to determine market value and the best path to realisation. The point of valuation of crypto assets could be a difficult and complex exercise for an IP given that the value of crypto

assets is often volatile. It is important that IPs have credible sales strategies that can withstand creditor scrutiny. In addition, if IPs are making a large disposal of crypto assets, they should also consider the potential impact that such a disposal may have on the overall market value of that particular type of crypto asset. In order to avoid a situation where the actions of IPs are called into question by creditors, it is advisable that IPs first seek the court's sanction to bless their realisation strategy for the crypto asset. The importance of seeking court sanction was demonstrated by the *Mt.Gox* case (a now defunct Bitcoin exchange) where the trustee made, in consultation with the court, a disposal of roughly 35,841 bitcoins for approximately US\$360m. The trustee's sale of Bitcoin was highly criticised by creditors as it was perceived to have significantly reduced the market price of Bitcoin and, as such, creditors claimed this was contrary to the trustee's duty to maximise and protect the value of the defunct exchange's assets. If the trustee had not consulted with the court prior to making this decision, it is likely that such challenges would have accelerated into litigation against the trustee.

Clawback

A third hurdle that a liquidator may face is dealing with assets that have been dissipated prior to their appointment. Under the Cayman Islands Companies Law (2018 Revision), a liquidator is provided with clawback provisions², which provide an array of options to challenge and review transactions preceding insolvency. Where a challenge is successful, the court will make an order to reverse any such transaction. The returned assets will then form part of the liquidation estate and be available to the liquidator to distribute. Although not yet tested in the Cayman Islands, it is likely that these tools would be applicable to a liquidator in Cayman or in another jurisdiction with similar clawback provisions in relation to crypto assets. In any event, notwithstanding whether it would be physically possible to claw back such transactions given the anonymity whereby users use pseudonymous, there are various alternative reliefs³, which a liquidator could seek from a Cayman Islands Court in order to increase yields to the insolvent estate. An important consideration for an IP to consider is whether the ultimate costs and time associated with tracing a crypto asset are greater than the amount that could be realised from the asset.

CONCLUSION

The Cayman Islands is a reputable jurisdiction in dealing with highly complex, multi-jurisdictional insolvencies. While the Cayman courts have yet to deal with the difficult questions arising out of insolvencies involving crypto assets, the question remains one of when it will happen rather than whether it will happen. More recently the Financial Action Task Force announced that they intend to insist that service providers dealing in crypto assets be obliged to comply with anti-money laundering procedures; such measures will certainly assist IPs in recovering crypto assets. With its sophisticated and modern legal framework, the Cayman Islands and its well-advised IPs will no doubt be adequately equipped to deal with these cases as they arise.

1. For the sake of brevity, this term will be used in this article to denote the myriad of digital currencies available (ie Bitcoin, Ripple, Ether, Dogecoin, Facebook Libra).
2. For example, section 145 voidable preference, s146 avoidance of transactions at an undervalue and s147 fraudulent trading.
3. For example, a Cayman Islands liquidator may apply under s103 for certain 'relevant persons' to be examined and/or deliver up property/documents. There are also a variety of common law orders, such as Norwich Pharmaceutical orders, Anton Piller orders, gagging orders and Bankers Trust orders.

For more information, please contact:

Paul Smith, head of Cayman Islands litigation and restructuring
T: +1 345 814 7777
E: paul.smith@conyers.com

Róisín Liddy-Murphy, attorney
T: +1 345 814 7371
E: roisin.liddy-murphy@conyers.com

Jordan McErlean, associate
T: +1 345 945 3901
E: jordan.mcerlean@conyers.com

Conyers – Cayman Islands

www.conyers.com