Creditor Considerations in Crypto Cases

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CREDITOR CONSIDERATIONS IN CRYPTO CASES

Alan Rosenberg*

Ross Hartog**

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INTRODUCTION

I hate to be that guy—but I told you so. Cryptocurrency and digital assets are not passing fads and will not go the way of the Tamagotchi, particularly in North America. According to Chainalysis, North America is one of the world’s largest crypto-economies, having received over $750 billion in cryptocurrency between July 2020 and June 2021. Cryptocurrency transaction volume has increased so dramatically that it has spurred changes in tax law, banking and finance practices, corporate governance, and even philanthropy. You may not like it, accept it, or agree with it, but cryptocurrency is here to stay—so exercise some restraint with your crypto-evangelist nephew at the holiday table this year.

Unfortunately, cryptocurrency’s popularity bears no correlation with its legislative or regulatory clarity. As aptly noted by Judge Wiles in the Voyager Digital Holdings bankruptcy case:

> There are firms that operate as cryptocurrency brokers or exchanges, and have done so for several years, without being subject to clear and well-defined regulatory requirements. Regulators themselves cannot seem to agree as to whether cryptocurrencies are commodities that may

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1. The Tamagotchi is a handheld, digital pet that was launched in 1996 and “became not just a toy fad, but a social phenomenon.” See Sebastian Skov Anderson, The Tamagotchi Was Tiny, but Its Impact Was Huge, WIRED MAGAZINE (Nov. 23, 2021, 8:00 AM), https://www.wired.com/story/tamagotchi-25-year-anniversary-impact/ (“If you’re a ’90s kid, you either owned one yourself or spent every recess looking over the shoulder of someone who did. But while the toy has pretty much disappeared from schoolyards these days—replaced by smartphones—many of its key features had a significant impact on the video game industry and live on in major games today.”).

2. CHAINALYSIS, THE 2021 GEOGRAPHY OF CRYPTOCURRENCY REPORT: ANALYSIS OF GEOGRAPHIC TRENDS IN CRYPTOCURRENCY ADOPTION AND USAGE 26 (2021), https://bitcoinke.io/wp-content/uploads/2021/10/Geography-of-Cryptocurrency-2021.pdf (“North America is the second-largest cryptocurrency economy we study, having received over $750 billion in cryptocurrency between July 2021 and June 2020 [sic], which accounts for 18.4% of global activity in that time period. The United States accounts for the majority of this activity, and also shows relatively high grassroots adoption, ranking eighth on our Global Crypto Adoption Index.”).

3. See, e.g., I.R.S. Notice 2014-21 (“This notice describes how existing general tax principles apply to transactions using virtual currency.”).

4. See, e.g., Alyssa Hertig, What Is DeFi, COINDESK (Feb. 10, 2023, 9:48 AM), https://www.coindesk.com/learn/what-is-defi/ (defining and analyzing decentralized finance, which is “an umbrella term for a variety of financial applications in cryptocurrency or blockchain geared toward disrupting financing intermediaries”).

5. See, e.g., Nathan Tse, Decentralised Autonomous Organisations and the Corporate Form, 51 VICTORIA U. WELLINGTON L. REV. 313, 314 (2020). A further analysis of decentralized autonomous organizations can be found in Part I.C of this Essay.

6. The Giving Block, for example, provides a platform for non-profit organizations to accept donations in cryptocurrency. See About The Giving Block, GIVING BLOCK, https://thegivingblock.com/about/#menu-about (last visited May 23, 2024).
be subject to regulation by the CFTC, or whether they are securities that are subject to securities laws, or neither, or even on what criteria should be applied in making the decision. This uncertainty has persisted despite the fact that cryptocurrency exchanges have been around for a number of years.

If the current regulatory environment can be characterized as uncertain, the future regulatory environment can only be characterized, in my mind, as virtually unknowable. There have been differing proposals in Congress to adopt different types of regulatory regimes for cryptocurrency trading. Meanwhile, the SEC has filed some actions against particular firms with regard to particular cryptocurrencies, and those actions suggest that a wider regulatory assault may be forthcoming. The CFTC seems to have taken some positions that are at odds with the SEC’s views. Just how this will all sort itself out, how the pending actions relating to cryptocurrencies will be decided, and just what issues might be raised in future regulatory actions, and how they will affect individual firms or the industry as a whole, is unknown.  

This level of uncertainty, coupled with a lack of uniform regulation, a handful of bad actors, and other crypto-related-stimuli have led to massive waves of crypto-related bankruptcy filings, large scale litigation, and high-profile criminal prosecutions.

These events have had profound impacts in the financial and insolvency arenas. Courts around the country are now being forced to address various matters of first impression, including legal versus equitable title of cryptocurrency, crypto-collateralization, and crypto-valuation methodologies. With the benefit of twenty-twenty hindsight, creditors’

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9 Id.
11 See, e.g., In re Celsius Network LLC, 647 B.R. 631, 637 (Bankr. S.D.N.Y. 2023) (analyzing, among other things, whether customers of the debtor had a legal or equitable ownership interest in the cryptocurrency they deposited into Earn Accounts).
13 See, e.g., In re Celsius Network LLC, 655 B.R. 301, 313 (Bankr. S.D.N.Y. 2023) (addressing a dispute regarding the valuation of the debtor’s native utility token).
attorneys must properly educate themselves to carefully structure debtor-creditor relationships when cryptocurrency is at issue. As the crypto landscape continues to evolve, here are a few of the considerations that crypto creditors ought to add to their checklist.

I. CONSIDERATIONS FOR CRYPTO CREDITORS

A. What Kind of Creditor Are You?

In the world of cryptocurrency, as in the traditional financial world, not all creditors are created equal. The crypto world’s more sophisticated players often require cryptocurrency or other digital assets to be pledged as security for their investments. Assuming their interest in such crypto-collateral is properly perfected, these secured creditors have assets—often in the form of cryptocurrency—upon which to execute, should their investment go awry. On the opposite end of the spectrum are unsecured creditors, i.e., oftentimes consumer creditors and those engaged in smaller cryptocurrency transactions. Without a collateral cushion to soften the blow of a failed investment, these unsecured creditors often receive less favorable treatment than their secured-creditor counterparts. Given these disparities in treatment, it is important for lawyers to take appropriate measures to protect their crypto-creditor clients. The failure to do so can lead to disastrous outcomes, particularly in the event of an insolvency proceeding.

1. Secured Crypto Creditors

At the top of the crypto-creditor totem pole are secured creditors. Secured creditors are creditors “who have access to collateral by virtue of a security agreement.” Properly perfected secured creditors generally have the most favorable standing in commercial-crypto disputes and, as a result, the most leverage. Until recently, the method for properly perfecting security interests in crypto collateral was uncertain, as was creditors’ ability to recover said collateral. Although the Uniform Commercial Code (the “UCC”) generally governs the secured status of creditors, the UCC did not previously—at least

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16 Mann, supra note 14, at 164–165; see Brock C. Jones, Comment, Failing To Capitalize on Collateral: A Look into Updating UCC Article 9 For Virtual Currency Secured Lending, 60 Hous. L. Rev. 693, 696 (2023).
until the addition of UCC Article 12—specifically contemplate the possibility of perfecting security interests in cryptocurrency and other digital assets.

a. A Brief History of the Uniform Commercial Code

In response to the interstate nature of commerce, in 1942 the Uniform Law Commission (the “ULC”) and the American Law Institute (the “ALI”) decided to develop a uniform set of laws to govern commercial transactions. The result of these efforts was what we now know as the UCC. The first version of the UCC was promulgated in 1951, and has been regularly amended to evolve with changes in the commercial world. While not every jurisdiction

17 See infra Part I.A.1.c.
18 About Us, UNIF. L. COMM’N, https://www.uniformlaws.org/aboutulc/overview (last visited May 23, 2024) (“Established in 1892, [the ULC] provides states with non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law.”).
19 About ALI, AM. L. INST., https://www.ali.org/about-ali/ (last visited May 23, 2024) (“The American Law Institute is the leading independent organization in the United States producing scholarly work to clarify, modernize, and otherwise improve the law. ALI drafts, discusses, revises, and publishes Restatements of the Law, Model Codes, and Principles of Law that are enormously influential in the courts and legislatures, as well as in legal scholarship and education.”).
20 By the time that the ULC and the ALI first worked together in 1942, the ULC had drafted a variety of uniform commercial laws including the Uniform Negotiable Instruments Law in 1896; the Uniform Sales Act and Uniform Warehouse Receipts Act in 1906; the Uniform Bills of Lading Act and Uniform Stock Transfer Act in 1909; and the Uniform Conditional Sales Act in 1918. See Uniform Commercial Code, UNIF. L. COMM’N, https://www.uniformlaws.org/acts/ucc (last visited May 23, 2024); see also Foster v. Hacienda Nirvana, Inc., 32 So.3d 1256, 1261 n.4 ( Ala. 2009) (“The Uniform Negotiable Instruments Law, ‘[t]he first codification of negotiable instruments law in the United States,’ was drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1896 and ‘was adopted by all states and territories of the United States in the early 1900s.’ . . . The NCCUSL and the American Law Institute drafted the Uniform Commercial Code (‘UCC’) in part as a replacement for the Uniform Negotiable Instruments Law. . . . The UCC superseded the Uniform Negotiable Instruments Law in Alabama on December 31, 1966.’) (internal quotations and citations omitted).
21 Uniform Commercial Code, supra note 20 (“The UCC is a joint project of the Uniform Law Commission and the American Law Institute. Recognizing that drafting a combined commercial code was a massive undertaking, the ULC invited ALI to participate in the codification project, and the ALI board accepted the invitation in 1942.”).
22 Id. (“The UCC is maintained under the guidance of the Permanent Editorial Board for the Uniform Commercial Code (PEB), comprised of members appointed by the ULC and the ALI.”).
has enacted every article of the UCC,\textsuperscript{23} Article 9, relating to secured transactions,\textsuperscript{24} has been adopted by nearly all jurisdictions.\textsuperscript{25}

\textbf{b. Life Before Article 12: UCC Article 9}

Prior to Article 12, creditors seeking to perfect security interests in cryptocurrency looked primarily to Article 9 of the UCC. While Article 9 implicates a wide range of secured transactions, it is nevertheless limited to transactions involving personal property, agricultural liens, sale of accounts, chattel paper, payment intangibles, promissory notes, and consignments.\textsuperscript{26} Article 9 also identifies various categories of assets capable of serving as collateral. These asset categories can be divided into three, unofficial, sub-categories: (1) goods,\textsuperscript{27} (2) so-called quasi-tangible property,\textsuperscript{28} and (3) intangible property.\textsuperscript{29} Each sub-category contains a collection of assets, and it is not always

\textsuperscript{23} Jurisdictions that have adopted some or all of the UCC include the fifty states, Puerto Rico, the U.S. Virgin Islands, and the District of Columbia. Statement on Central Bank Digital Currency and the 2022 UCC Amendments, UNIF. L. COMM’N (April 12, 2023), https://higherglogicdownload.s3.amazonaws.com/UNIFORMLAWS/b7ec515db-1895-4387-bb2d-ee99c58c0066/UploadedImages/Documents/ULC_Statement_on_the_UCC_and_CBDCs.pdf.

\textsuperscript{24} For purposes of this Essay, the use of the term “Article 9” will refer to the 2010 amendment to Article 9 of the UCC unless otherwise noted. U.C.C. § 9 (AM. L. INST. & UNIF. L. COMM’N 2010).

\textsuperscript{25} See 1998 UCC Article 9 Enactment Map, UNIF. L. COMM’N, https://www.uniformlaws.org/committees/community-home?CommunityKey=6317f73b-badb-47b2-8a5a-58ee62032ba1 (last visited May 23, 2024). But see 2010 UCC Article 9 Enactment Map, UNIF. L. COMM’N, https://www.uniformlaws.org/committees/community-home?CommunityKey=16ac023-5df6-4857-bef5-46cf98c0b18 (last visited May 23, 2024) (showing that the 2010 amendments to Article 9 have not been adopted by U.S. Virgin Islands); 2010 UCC Article 9 Enactment Map, UNIF. L. COMM’N, https://www.uniformlaws.org/committees/community-home?CommunityKey=6e64b34-53ad-4e2e-a12c-f65367d80b00 (last visited May 23, 2024) (2018 amendments to Article 9 only adopted by eight jurisdictions).

\textsuperscript{26} See U.C.C. § 9-102(a)(44) (AM. L. INST. & UNIF. L. COMM’N 2010). Article 9 provides that “goods” are general physical, tangible items and include: consumer goods, id. § 9-102(a)(23); equipment, id. § 9-102(a)(33); farm products, id. § 9-102(a)(34); and inventory, id. § 9-102(a)(48). The three basic categories of assets capable of being collateral are clearly articulated by Professor Pulley Radwan’s flowchart. See Jacqueline N. Feliciano & Theresa J. Pulley Radwan, Flowchart – Slide 3: Collateral Classification, STETSON U. COLL. L. (2018), https://www.stetson.edu/law/faculty/home/media/radwan-theresa-j-pulley-flowcharts/3-Collateral-Classification.png.

\textsuperscript{27} Intangible property is not physical or tangible and includes: accounts, U.C.C. § 9-102(a)(2) (AM. L. INST. & UNIF. L. COMM’N 2010); commercial tort claims, id. § 9-102(a)(13); deposit accounts, id. § 9-102(a)(29); general intangible, id. § 9-102(a)(42); health-care-insurance receivables, id. § 9-102(a)(46); and payment intangibles, id. § 9-102(a)(61). See also Feliciano & Pulley Radwan, supra note 27.
clear to which category any particular asset belongs. Indeed, some assets can fit within more than one category depending on the context.\textsuperscript{30}

The above distinctions are important because they determine the proper method by which a secured creditor can perfect its security interest. “Perfection . . . means the process by which the security interest . . . achieves a status where it cannot be avoided by an intervening third party.”\textsuperscript{31} Perfection provides constructive notice of a secured creditor’s interest in an asset that a debtor has offered as collateral. The UCC prescribes a variety of methods to perfect a security interest, including filing a UCC-1 Financing Statement,\textsuperscript{32} taking possession of the collateral,\textsuperscript{33} and taking control of the collateral.\textsuperscript{34}

While Article 9 provides a useful framework for most transactions, it did not, in its prior form, contemplate the existence or use of cryptocurrency in secured transactions. As a result, the proper method by which to perfect an interest in cryptocurrency was never entirely clear under Article 9. Some even argued that Article 9 did not apply at all, and that the “uncertainty [of] virtual currency as collateral reduces the likelihood it will be accepted as collateral under the present laws.”\textsuperscript{35}

c. **UCC Article 12 and the 2022 Amendments to the UCC**

Perhaps recognizing the deficiencies in Article 9:

[T]he Uniform Law Commission and The American Law Institute . . . appointed a Joint Committee to consider whether changes to the UCC are advisable to accommodate emerging technologies, such as artificial intelligence, distributed ledger technology, and virtual currency. The Joint Committee was initially formed as a study committee, but subsequently was constituted as the Drafting Committee to prepare amendments to the UCC.\textsuperscript{36}

\begin{footnotes}
\item[30] For example, if a debtor manufactures or is in the business of selling forklifts then a forklift could be considered “inventory.” U.C.C. § 9-102(a)(48) (AM. L. INST. & UNIF. L COMM’N 2010). However, if the debtor is in the business of selling furniture and uses a forklift to move the furniture in the debtor’s warehouse, the forklift could be considered “equipment.” Id. § 9-102(a)(33).

\item[31] In re KNM Roswell Ltd. P’ship, 126 B.R. 548, 552–53 (Bankr. N.D. Ill. 1991) (citing In re Park at Dash Point, LP, 121 B.R. 850, 853 (Bankr. W.D. Wash. 1990)).


\item[33] U.C.C. § 9-313 (AM. L. INST. & UNIF. L COMM’N 2010).

\item[34] U.C.C. § 9-314 (AM. L. INST. & UNIF. L COMM’N 2010).

\item[35] Sharon E. Foster, *Virtual Currency as Crypto Collateral Under Article 9 of the UCC: Trying To Fit a Square Peg in a Round Hole*, 73 Ark. L. Rev. 263, 299 (2020).

\item[36] U.C.C. AMENDS. prefatory note, at 1 ¶ 1 (AM. L. INST. & UNIF. L COMM’N 2022).
\end{footnotes}
The committee’s work culminated in the drafting and approval of the 2022 amendments to the UCC (the “2022 Amendments”), which have already been adopted by several states.\footnote{As of May 2024, twenty states and the District of Columbia have enacted the 2022 Amendments: Alabama, California, Colorado, Delaware, Georgia, Hawaii, Indiana, Iowa, Kentucky, Maine, Minnesota, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Oklahoma, South Dakota, Virginia, and Washington. Eight legislatures have introduced, but not enacted the 2022 Amendments: Illinois, Louisiana, Massachusetts, Missouri, New York, Pennsylvania, Rhode Island, and West Virginia. See 2022 UCC Amendments Enactment Map, UNIF. L. COMM’N, https://www.uniformlaws.org/committees/community-home?CommunityKey=1457c422-ddb7-40b0-8c76-39a1991651ac (last visited May 23, 2024).}

Of pertinence to cryptocurrency creditors is the creation of UCC Article 12, which specifically addresses property rights in cryptocurrency and other forms of digital assets, including but not limited to, non-fiat virtual currency and nonfungible tokens (“NFTs”).\footnote{U.C.C. § 12-102(a)(1) (AM. L. INST. & UNIF. L COMM’N 2022).} The term “Controllable Electronic Records” (“CERs”) was adopted to identify what will and what will not be governed by Article 12 and encompasses records “stored in an electronic medium that can be subjected to control under Section 12-105.”\footnote{U.C.C. § 12-102(a)(1) (AM. L. INST. & UNIF. L COMM’N 2022).}

The definition of CERs excludes certain items, such as controllable accounts, controllable payment intangibles, deposit accounts, electronic copies of records evidencing chattel paper, electronic documents of title, electronic money,\footnote{The exclusion of electronic money from the definition of a CER might cause our readers to ask how Article 12 applies to cryptocurrency. The answer is a simple but technical one. We first can look to Article 9 which defines electronic money as “money in electronic form”. U.C.C. § 9-102(31A) (AM. L. INST. & UNIF. L COMM’N 2022). While that may not seem helpful at first, it becomes more meaningful upon reading the definition of money in Article 1: “‘Money’ means a medium of exchange that is currently authorized or adopted by a domestic or foreign government.” U.C.C. § 1-201(24) (AM. L. INST. & UNIF. L COMM’N 2022). Adoption by a government is the key distinction and is the key to why electronic money and cryptocurrency are two very different things. Electronic money is a digital form of money backed by a governmental backed currency that can be exchanged into the actual underlying currency. Cryptocurrency, on the other hand, is not tied to a government backed currency and is not therefore subject to any sort of governmental regulations. Andrew Bloomenthal, What Is Electronic Money or eMoney?, INVESTOPEDIA (Mar. 6, 2024), https://www.investopedia.com/terms/e/electronic-money.asp. This also appears to be a conscious decision on the part of the drafters of Article 12 to continue to subject government backed money—even electronic money—to the UCC’s preexisting rules for money. See Statement on Central Bank Digital Currency and the 2022 UCC Amendments, supra note 23.} investment property, and transferable records.\footnote{U.C.C. § 12-102(a)(1) (AM. L. INST. & UNIF. L COMM’N 2022).} The drafters of UCC Article 12 intended to:

create[ ] a legal regime that is meant to apply more broadly than to electronic (intangible) assets that are created using existing technologies such as distributed ledger technology (DLT), including...
blockchain technology, which records transactions in bitcoin and other digital assets. It also aspires to apply to electronic assets that may be created using technologies that have yet to be developed, or even imagined.42

It is unclear whether the hopes and expectations of Article 12’s drafters have been realized, at least as it pertains to cryptocurrency. At the time of writing this Essay, there was only one reported decision citing Article 12, but it did not concern cryptocurrency; instead, it addressed a debtor’s ownership interest in social media accounts.43 Accordingly, crypto-creditors seeking guidance beyond the plain language of Article 12 will need to wait for Article 12 jurisprudence to develop and mature through the legal system.

d. Controllable Electronic Records and Related Amendments to the UCC

As noted above, CERs are “record[s] stored in an electronic medium that can be subjected to control.”44 Control, the crucial factor for a CER determination, is undefined by Article 12 or the broader 2022 Amendments. In the absence of a UCC-created definition, courts have been left to their own devices to determine exactly what “control” means. One such court has determined that a person has “control” over an electronic record where they “have (1) the power to avail itself substantially of all the electronic record’s benefits; (2) the exclusive power to prevent others from doing so; and (3) the electronic record enables the person readily to identify itself in any way . . . as having [those] powers.”45 The ability to “control” a CER is intended to mimic the concept of “possession” of a tangible asset.46 By way of example, holding cryptocurrency in a non-custodial cryptocurrency wallet47 would likely constitute “control” under Article 12.

42 U.C.C. AMENDS., prefatory note to Art. 12, at 229 (AM. L. INST. & UNIF. L COMM’N 2022).
46 See U.C.C. AMENDS., prefatory note, at 1 ¶ 2(a) (AM. L. INST. & UNIF. L COMM’N 2022) (“Control is best understood in a general sense as the functional equivalent of ‘possession’ of a controllable electronic record . . . .”).
47 One court helpfully articulated what a cryptocurrency wallet does:

A cryptocurrency wallet is an application that holds the private keys necessary to access or transact cryptocurrency. Wallets do not physically hold cryptocurrency, but rather hold only the private keys required to transact with a given wallet address. Wallets can be accessed remotely only when the user inputs the appropriate access credentials.

Terpin v. AT&T Mobility, LLC, 664 F Supp.3d 1086, 1089 (C.D. Cal. Mar. 28, 2023) (citations omitted). A non-custodial wallet is “where the crypto owner is fully responsible for managing their own funds. The user has
In addition to adopting Article 12, the 2022 Amendments also include important crypto-related amendments to other articles of the UCC. Many of these amendments address obtaining and perfecting security interests in CERs. Notably, perfection of security interests in CERs can be achieved by either: (1) obtaining control of the asset; or (2) filing a financing statement in the appropriate jurisdiction’s filing office. However, a security interest in a CER that is perfected by control has priority over a security interest that is perfected solely by filing a financing statement.

Article 12 also provides guidance on determining a CER’s jurisdiction and thus, the appropriate governing law as it pertains to UCC enforcement issues. Article 12 makes clear that “the local law of a controllable electronic record’s jurisdiction governs a matter covered by this article.” Accordingly, identifying a CER’s jurisdiction is of paramount importance. Fortunately, Article 12 provides guidance, with the starting point being the CER itself. If the CER, or a record associated with the CER that is “readily available for review,” expressly identifies a particular jurisdiction as the CER’s jurisdiction for purposes of Article 12 or the UCC, then that specified jurisdiction controls. If no such information is readily available or expressly identified, then the CER’s jurisdiction is the jurisdiction whose law governs the system in which the CER is recorded. If no express provision is made in the CER or the system in which the CER is recorded, the CER’s jurisdiction is Washington, D.C. And if Washington, D.C., has not enacted Article 12, then the governing law will be the law of Washington, D.C., as if Article 12 had been enacted. Ironically, it was only recently that Washington, D.C. enacted Article 12.

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49 U.C.C. § 9-312(a) (Am. L. Inst. & Unif. L COMM’N 2022) (“A security interest in chattel paper, controllable accounts, controllable electronic records, controllable payment intangibles, instruments, investment property, or negotiable documents may be perfected by filing.”).


57 2022 UCC Amendments Enactment Map, supra note 37.
Crypto creditors must strictly adhere to the guidelines set forth in the UCC and Article 12 to ensure the enforceability of their security interests. This is particularly important in a bankruptcy proceeding because “section 544(a) of the Code, also referred to as the ‘strong arm’ clause, allows a trustee in bankruptcy to avoid liens and security interests against the debtor’s estate which were not properly perfected under state law prior to the debtor’s bankruptcy filing.”\(^{58}\) In other words, the failure to properly perfect security interests in cryptocurrency prior to a bankruptcy case, will render such liens useless after the case is commenced.

2. Unsecured Crypto Creditors

On the opposite end of the spectrum are unsecured creditors. Being an unsecured creditor in a commercial cryptocurrency dispute—or even worse, a bankruptcy proceeding—is not an enviable position. An unsecured creditor is “a creditor who, upon giving credit, takes no rights against specific property of the debtor.”\(^{59}\) Outside of bankruptcy, unsecured creditors have limited options for tangible recovery. While unsecured crypto-creditors can generally pursue the same kinds of legal claims that would otherwise be available in fiat transactions,\(^{60}\) recovering their cryptocurrency can be a daunting and expensive task. In a bankruptcy proceeding, unsecured crypto-creditors fare no better. General unsecured creditors occupy a low priority of payment under the Bankruptcy Code (the “Code”), which often leads to minimal recoveries, particularly when the creditor body is dominated by secured creditors.\(^{61}\) An examination of recent crypto-insolvency cases is particularly instructive on the economic effects of being deemed an unsecured creditor.

Consider the Celsius Network LLC (“Celsius”) bankruptcy case.\(^{62}\) Celsius was once “one of the largest Cryptocurrency based finance platforms in the world, providing financial services to institutional, corporate, and retail clients

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across more than 100 countries.” Increased regulatory scrutiny, coupled with 2022’s “crypto winter,” resulted in a “run on the bank” that led to a liquidity crisis. In response, Celsius put a pause on all withdrawals, swaps, and transfers of tokens on its platform, and commenced a chapter 11 bankruptcy.

Many of Celsius’ users were enrolled in its “earn program,” which allowed customers to earn interest on cryptocurrency they deposited with Celsius. These users did not execute or record any security agreements, financing statements, or other documents with Celsius to evidence a security interest in their cryptocurrency. On the petition date, “Celsius had approximately 600,000 accounts in its Earn program,” which held crypto-assets “with a market value of approximately $4.2 billion as of July 10, 2022.”

After the bankruptcy filing, disputes arose as to who owned the cryptocurrency in the earn accounts; the Debtor argued that it owned the cryptocurrency, while earn-account holders argued that the cryptocurrency was theirs and should be returned to them. After analyzing Celsius’ Terms of Use, the Court determined that:

[T]he language in the Terms of Use transferring all ownership interest to Celsius in the cryptocurrency assets deposited in the Earn Accounts makes it very clear that no ownership interest or lien in favor of the Account Holders was intended. And certainly no lien in favor of the Account Holders was perfected.

As a result, the earn-account holders were deemed general unsecured creditors. And as unsecured creditors, the earn-account holders have no collateral, i.e., they lost their rights to the cryptocurrency in their accounts and are now subject to

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63 Disclosure Statement for the Joint Chapter 11 Plan of Reorganization of Celsius Network LLC and its Debtor Affiliates at 12, Celsius, No. 22-10964, ECF No. 2902.
65 Disclosure Statement for the Joint Chapter 11 Plan of Reorganization of Celsius Network LLC and its Debtor Affiliates at 12, Celsius, No. 22-10964, ECF No. 2902.
67 Id. at 658 (analyzing the lack of security instruments governing the relationship between Celsius and its Earn Account Holders).
68 Id. at 637.
69 Id.
70 Id. at 658 (footnote omitted).
71 Id. (“General, unsecured creditors lack a particularized interest in specific assets.”) (quoting United States v. Speed Joyeros, S.A., 410 F.Supp.2d 121, 125 (E.D.N.Y. 2006)).
being paid through Celsius’ bankruptcy plan under the priority scheme provided by the Code.\textsuperscript{72}

Being deemed an unsecured creditor in a crypto-centric bankruptcy case can have other negative consequences, as well. For example, during the aforementioned crypto-winter, many customers withdrew their cryptocurrency from now-bankrupt cryptocurrency exchanges and financial platforms.\textsuperscript{73} To the extent that those withdrawals were made within ninety days of the platforms filing for bankruptcy, these customers—assuming they are deemed unsecured creditors—may now be subject to being sued to recover preference payments under section 547 of the Code.\textsuperscript{74}

\section*{B. Cryptocurrency Valuation Issues}

Valuation is among the most important, and simultaneously puzzling, aspects of crypto-centric legal disputes. Determining “[t]he value of a crypto asset or business will help inform a party’s decision on what causes of action and remedies to pursue in a crypto dispute and, therefore, impact the overall dispute strategy.”\textsuperscript{75} This preliminary analysis serves to guide litigants in choosing “between claiming for delivery of a cryptoasset, or shares in a crypto business (eg, specific performance), versus damages quantified in fiat currency.”\textsuperscript{76}

Unfortunately, determining the proper method by which to value cryptocurrency in creditor disputes presents unique challenges. Cryptocurrency’s inherent volatility renders it impractical to fashion a one-size-fits-all valuation strategy. For example, in the context of valuing proofs of claims in bankruptcy cases, crypto-creditors—particularly in circumstances where the value of the cryptocurrency at issue has risen or is expected to rise—do not want their claims valued as of the petition date; these creditors want to realize the

\begin{itemize}
\item \textsuperscript{72} Id. at 637–38.
\item \textsuperscript{74} A preference is a type of “claw back” action found in 11 U.S.C. § 547, and the elements needed to establish a preference are set forth in 11 U.S.C. § 547(b). For the sake of simplicity:
\begin{quote}
The concept of a preference is a very basic one; namely, that one creditor, who has been advantaged by the prebankruptcy transfer from an insolvent debtor of cash or security, should return that cash to the bankruptcy estate (or lose that security) in order to ensure equality among all of the debtor’s similarly positioned creditors.
\end{quote}
\item \textsuperscript{75} Symposium, \textit{BAPCPA at Ten: Bankruptcy Preferences: Recalcitrant Passengers Aboard the Flight from Creditor Equality}, 90 AM. BANKR. L.J. 329, 337 (2016).
\item \textsuperscript{76} Elizabeth Chan et al., \textit{Crypto Disputes: The Valuation Challenge}, 17 DISP. RESOL. INT’L 21, 32 (2023).
\end{itemize}
benefit of appreciation. In contrast, defendants in commercial litigation cases—perhaps a breach of contract involving crypto-collateral—may seek to utilize crypto-valuation strategies that minimize the extent of their exposure. In short, the selection of an appropriate crypto-valuation methodology will depend upon the nature and stage of the crypto-dispute, as well as the characteristics of the underlying cryptocurrency at issue.

1. Contractually Defined Valuation

Perhaps the best way for creditors to avoid potential valuation disputes in crypto-related transactions is to contractually flesh them out during the negotiation phase. There are a few ways to hammer this out during negotiation:

[T]he parties could agree that certain breaches will trigger an obligation to transfer specified cryptoassets held in a designated custody service or pay liquidated damages. Or the parties could specify a date at which the assets should be valued, a range of prices to be used, or a methodology to be employed.77

Preemptively addressing valuation issues in the contract itself will remove the uncertainty inherent in allowing third parties who are unfamiliar with the underlying transaction, i.e., a judge, arbitration panel, or jury, to decide the appropriate measure of damages.

2. Valuation in Cryptocurrency Litigation: The “New York Rule”

If the contract at issue does not address valuation and litigation subsequently ensues, creditors’ attorneys involved in crypto-disputes must carefully analyze the specific facts and circumstances applicable to their dispute to determine an appropriate valuation methodology. Because case law regarding cryptocurrency valuation is scarce, courts addressing valuation issues in cryptocurrency-focused litigation have drawn analogies between related legal fields to fashion a practical valuable model.

In one such case, *Diamond Fortress Technologies, Inc. v. EverID, Inc.*,78 the court was asked to determine the appropriate calculation of damages in a cryptocurrency dispute, where the plaintiff was to be paid cryptocurrency in

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77 Id. at 41.
connection with an Initial Coin Offering. After having determined that the cryptocurrency at issue was a security under the Howey test, the court then determined that it needed to adopt “a reliable cryptocurrency valuation source to ensure the proper input of values.” The court turned to CoinMarketCap and found that it was appropriate to “rely on historical pricing data published by CoinMarketCap to determine the proper USD value of ID Tokens in calculating the Plaintiffs’ forthcoming judgment.”

After having determined that the cryptocurrency at issue was a security and that historical pricing could be obtained from CoinMarketCap, the court analogized the plaintiff’s case to a “failure to deliver securities” case, noting that “[b]ut for the novelty of the subject instrument being units of cryptocurrency this suit mirrors any other failure to deliver securities case—a run-of-the-mill action for Delaware courts.” Using this cause of action as a template for modeling damages, the court applied the so-called “New York Rule:”

Known as the New York Rule, the “highest value within a reasonable time” framework is a judicially-created breach-of-contract remedy for reckoning “damages where stock or ‘properties of like character’ were converted, not delivered according to contractual or other legal obligation, or otherwise improperly manipulated.” It’s frequently employed in wrongful stock conversion litigation and measures damages by: “the highest intermediate value reached by the stock between the time of the wrongful act complained of and a reasonable time thereafter, to be allowed to the party injured to place himself in the position he would have been in had not his rights been violated.”

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79 Id. at 297 (“Like an initial public offering in a securities context, an initial coin offering, or ICO, occurs when a new species of cryptocurrency token is issued in exchange for fiat or already circulating virtual currencies to raise capital.”).
80 The landmark case of SEC v. W.J. Howey Co., 328 U.S. 293 (1946), analyzed whether a transaction is an “investment contract,” and thus, a security. As noted by the court in Diamond Fortress Techs., “courts have looked to Howey to ascertain whether cryptocurrencies qualify as an unconventional scheme or contract that is governed by securities laws.” Diamond Fortress Techs., 274 A.3d at 299.
81 Diamond Fortress Techs., 274 A.3d at 305.
82 Id. (“CoinMarketCap is used frequently by news publications to report on prices of virtual currencies, including publications that focus on virtual currencies such as CoinDesk and general financial newspapers like the Wall Street Journal and the Financial Times.”) (quotations omitted).
83 Id.
84 Id. (quoting Galigher v. Jones, 129 U.S. 193, 200 (1889)). The Supreme Court in Galigher v. Jones adopted New York’s modification of the old-English rule that “in these cases that, where there has been a loan of stock and a breach of the agreement to replace it, the measure of damages will be the value of the stock at its highest price on or before the day of trial.” Galigher, 129 U.S. at 201.
The court further determined that three months was a reasonable time for purposes of determining the highest value of the cryptocurrency. Accordingly, the plaintiff’s damages were calculated by simply multiplying the total number of cryptocurrency tokens due to the plaintiff under its contract, by the cryptocurrency’s “highest intermediate value within three months of the discovery of [the] breach.”

While the Diamond Fortress Techs. court drew parallels between the cryptocurrency at issue and securities, a closer review of the New York Rule indicates that it could potentially apply to most cryptocurrencies, regardless of whether they are deemed securities. The New York Rule is intended to apply in instances where stock or “properties of like character,” i.e., property whose value fluctuates, is “converted, not delivered according to contractual or other legal obligation, or otherwise improperly manipulated.” As a result, the New York Rule and similar damage models have been employed in various non-securities cases. Accordingly, regardless of whether the cryptocurrency at issue is a security, commodity, or asset class, its inherent ability to fluctuate in value makes it appropriate to apply some version of the New York Rule.

3. Valuation in Bankruptcy Case Administration

In bankruptcy proceedings, claims are valued in U.S. dollars, as of the date of the filing of the bankruptcy petition. Recognizing the challenges inherent in assigning values to crypto-based claims, courts have authorized the use of amended proof of claim forms to address cryptocurrency valuation concerns. For example, in the bankruptcy cases of FTX Trading LTD and its affiliated debtors, the standard proof of claim form was amended to allow customers to

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85 Id. at 308 (citing various cases and noting that “[t]wo or three months has been accepted as a reasonable period of time to replace an asset on the open market”).
86 Id.
87 Schultz v. Commodity Futures Trading Comm’n, 716 F.2d 136, 141 (2d Cir. 1983).
88 See, e.g., Nephi Processing Plant, Inc. v. Talbott, 247 F.2d 771, 774 (10th Cir. 1957) (calculating damages for wrongful conversion where turkeys were sold at the wrong time in breach of instructions to sell at a later date); Letson v. Dean Witter Reynolds, Inc., 532 F.Supp. 500 (N.D. Cal. 1982) (calculating damages in a case involving the alleged wrongful liquidation of customers’ commodities futures trading accounts when market declines rendered the accounts’ margins inadequate); Rivinus v. Langford, 75 F. 959, 961 (2d Cir. 1896) (determining the damages for conversion of a judgment, where the value of the judgment was dependent on the judgment debtor’s degree of solvency).
89 11 U.S.C. § 502(b) (stating that if an objection to a claim is made “the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition”).
list the quantity of each type of cryptocurrency in their account(s) as of the petition date, whether the crypto was loaned or staked, as well as each customer’s ownership interest in any NFTs. The use of amended proof of claim forms to account for crypto-based claims has also been approved in other bankruptcy cases, including Celsius Network, LLC, Voyager Digital Holdings, and Cred Inc.

Allowing creditors to assert claims in cryptocurrency rather than U.S. dollars, leaves open the possibility for creditors to be paid back in-kind—by cryptocurrency—rather than having their claims “dollarized.” By avoiding dollarization of their claims, creditors who are optimistic about the future value of the cryptocurrency comprising their claim are afforded the opportunity to potentially benefit from a post-petition uptick in the valuation of their cryptocurrency.

C. Commercial Transactions with Decentralized Autonomous Organizations

When negotiating commercial transactions, it is always important for creditors’ attorneys to conduct thorough due diligence. Creditors’ attorneys must carefully consider available avenues for recourse should the underlying transaction fail or an event of default occur. For these reasons, creditors’ attorneys often request security in the form of collateral, personal guarantees, pledges, and the like. Without these additional layers of protection, a creditor’s collection efforts may be limited, at least preliminarily, to the assets of a potentially insolvent or non-operational company. When working with a decentralized autonomous organization (“DAO”), however, a creditor’s default remedies may be broader.

95 Dollarization simply refers to the conversion of crypto-based claims into dollars, rather than paying the claims “in-kind” through cryptocurrency distributions.
I. What Is a DAO, and Who Is Liable?

Simply put, a DAO:

is a management structure that allows the holders of governance tokens to vote on organizational decisions. Typically, to form a DAO, a core developer group creates a protocol, layered on top of an existing blockchain, that allows for the distribution of governance tokens to users, backers, and other stakeholders. The protocol often specifies quorum requirements to submit a voting proposal, as well as rules for voting. Each token typically corresponds to a set amount of voting power within the organization and also corresponds to a variable price on a secondary market, where the token maybe bought and sold. Although DAOs often describe themselves as highly decentralized and democratized, the actual governance authority of DAOs is often highly concentrated, and the core developer group often remains closely involved in managing, promoting, and proposing changes to the protocol to be voted upon by the DAO.96

A handful of states, such as Wyoming, have adopted statutes that treat DAOs similarly to limited liability companies.97 In these instances, the liability of DAO members may be statutorily limited.98 In other states, however, DAOs are not legally recognized corporate forms. In these states, the protections typically afforded to the members and owners of corporate entities may not be available to DAO token holders. As a result, some have argued that DAOs—at least in jurisdictions without DAO statutes—should be treated as general partnerships and thus, that each “partner” is jointly and severally liable for the DAO’s liabilities.99

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97 WYO. STAT. ANN. § 17-31-103 (“The Wyoming Limited Liability Company Act applies to decentralized autonomous organizations to the extent not inconsistent with the provisions of this chapter . . . “); see WYO. STAT. ANN. § 17-31-101 (the “Wyoming Decentralized Autonomous Organization Supplement”).
98 See, e.g., WYO. STAT. ANN. § 17-31-110 (“Unless otherwise provided for in the articles of organization or operating agreement, no member of a decentralized autonomous organization shall have any fiduciary duty to the organization or any member except that the members shall be subject to the implied contractual covenant of good faith and fair dealing.”).
99 Sarcuni v. bZx DAO, 664 F.Supp.3d 1100, 1114 (S.D. Cal. 2023) (“Plaintiffs’ theory of liability is premised on the existence of a general partnership among all persons holding BZRX tokens. The FAC contends Defendants are partners of the purported bZx DAO general partnership, and, therefore, jointly and severally liable for Plaintiffs’ injuries.”) (citations omitted).
2. bZx DAO: Expanding the Web of Liability

In Sarcuni v. bZx DAO, for example, the court was asked to determine the propriety of a putative class action complaint alleging negligence against the holders of BZRX tokens—the governance token issued by the defendant, bZx DAO.100 The operative complaint in Sarcuni alleged that bZx DAO, like most DAOs, did not adopt “a formal corporate structure, [and] opt[ed] instead to distribute governance rights among persons who [held] a specific governance token. Tokenholders [could] propose and vote on actions for the affiliated DAO to take. If a proposal receive[d] the required number of votes, the DAO adopt[ed] the proposal.”101 To determine the scope of liability, the court analyzed California partnership law and the particular facts at issue. In partially denying the motion to dismiss, the court stated that it “disagree[d] that recognizing the bZx DAO as a general partnership would be a ‘radical expansion and alteration of long-standing principles of partnership law [that] should not be countenanced.”102 In holding that bZx DAO was a general partnership, the court further noted that anyone holding a BZRX token would be deemed a member of the partnership and thus potentially subject to liability.103

3. DAO Considerations After Sarcuni

Because the case was jointly dismissed, presumably due to a settlement, the Sarcuni court did not have the opportunity to make additional substantive rulings. The court’s opinion, however, is instructive in determining the potential scope of liability in DAOs that are formed in non-DAO-statute states.104 Given that DAO members could potentially be held personally liable for the transgressions of a DAO, creditors of such DAOs may want to require periodic reporting regarding the holders of DAO governance tokens. DAO creditors may also want additional reporting from the DAO governance token holders, themselves. That way, in the event of a default, the DAO’s creditor can effectuate service of process and more effectively locate assets upon which to execute.

100 Sarcuni, 664 F.Supp.3d 1100.
101 Id. at 1109 (citations omitted).
102 Id. at 1118 (citations omitted) (second alteration in original).
103 Id. at 1125.
104 Determining the state in which a DAO was formed is a separate inquiry that is beyond the scope of this Essay.
CONCLUSION

Hardly a day goes by without at least one news headline pertaining to cryptocurrency. In fact, the cryptocurrency market has undergone a remarkable transformation while this Essay was being written. Indeed, with the U.S. Securities and Exchange Commission’s latest approval of spot bitcoin ETF’s, the price of Bitcoin nearly tripled. There are some who believe that cryptocurrency is nearing the start of a new “bull run,” with Bitcoin potentially increasing to over $100,000 in value. As cryptocurrencies’ popularity, acceptance, and integration into financial markets continues to expand, it is imperative that creditors, even those who oppose the existence of cryptocurrency, educate themselves about the intricacies of working with cryptocurrency in commercial transactions. Regardless of personal beliefs, it is not difficult to accept that, for better or worse, cryptocurrency appears to be sticking around—at least for a while. As a group of famous 20th century poets once noted, “m]y soliloquoy may be hard for some to swallow, but so is cod liver oil.” And like swallowing cod liver oil, learning about cryptocurrency can be difficult, but it is good for you—I promise.


107 OUTKAST, Wheel of Steel, on ATLIENTS (LaFace Records 1996).