

A CMS Guide to Restructuring & Insolvency in Crypto

Contents

- 3 Crypto
- 4 What we know
- 5 What we don't know
- 6 Who and what you need to know
- 8 Crypto at CMS
- 9 Restructuring & Insolvency at CMS
- 10 Contact us



Crypto. Cryptoassets are in the spotlight for many reasons. The use of cryptocurrencies as an alternative to fiat currencies is being explored and tested further by global events. Their correlation with traditional stores of value is being tested in volatile markets. Their status as both a potential means of avoiding sanctions and as a possible means of funding charitable and humanitarian causes is being demonstrated and discussed.



Innovation. Cryptoassets and blockchain remain sources of deep and rapid innovation in financial markets. They are proving to be both investable and adoptable in financial markets.



Information or misinformation? Alongside all that, the crypto market can be a source of information, misinformation and unsound assumptions. But good sources of information do exist, and the transparency of databases means that in fact it is easier to test hypotheses and investigate transactions with access to the right tools.



Different projects. It is important to remember that not all crypto projects are the same (or even similar). Projects can gain or lose value in the markets very quickly, but many have fundamentals that retain value because of a combination of technical innovation, teams, brand, developed software, value in the native token or in investments made using proceeds of token issuances, access to investors, community engagement, and many other reasons.



New tools and softwares exist – and are ever evolving. These give us the ability to track and trace cryptoassets to be sure to avoid sending or receiving cryptoassets from undesired locations or sources. This makes it more possible than ever before to comply with AML requirements as well as any sanctions that may be in place.



CMS. At CMS, we have a large and dedicated team experienced in all areas of crypto transactions. The combination of our market leading crypto team and our outstanding restructuring and insolvency team makes us uniquely placed to advise you on transactions in this space.



What we know

Cryptocurrencies qualify as 'property' under English law

This means that Office Holders are required to get in and realise these assets for the benefit of creditors. It is likely that Office Holders will face significant challenges in locating, getting control of and realising such assets, including when to exchange cryptocurrencies into fiat currencies. We shall see if this applies to all cryptoassets.

And so?

As they are property, Office Holders can obtain proprietary injunctions and freezing orders over cryptocurrencies, which can be instrumental in asset recovery.

The role of the Courts

The Courts in England and Wales have been willing to grant worldwide freezing orders against persons unknown, in the context of cryptocurrency recoveries. These orders can then be served on centralised crypto exchanges or other custodial wallet hosts to require relevant assets to be frozen and protected from dissipation and misuse.

Locating cryptoassets

This can sometimes be difficult, particularly if you don't know what you are looking for. We work with specialist forensic blockchain analytics partners to help identify, trace and recover crypto assets, including through Court orders (including disclosure and banker's trust style orders) where required.

Custody of crypto from seizures, restructuring and insolvency

There are times where cryptoassets may be a part of a seizure in a restructuring or insolvency case. In these cases, it is imperative to send and then store the cryptoassets somewhere safe, where it cannot be hacked. We have relationships with the key custody firms that offer institutional grade security to ensure any cryptoasset is held in the safest possible ways for its rightful owners.

Trusts

The Court has indicated that cryptocurrencies can be held on trust (it remains to be seen if this will apply to all cryptoassets) and so there may be a proprietary claim to it. This can also be relevant when acting for a party that is in possession of cryptoassets held on behalf of others. In that context it will be important to review the basis on which that cryptoasset is being held and how it ought to be treated for distribution purposes.

Related claims

There may also be claims connected to cryptoassets and related trading that could be part of a person's estate. This could take the form of claims against exchanges and platforms and also bilateral claims against their counterparties to the transactions. The claims could range from mis-selling claims that are premised on the basis of information and any representations that were made at the time of the purchase to contractual claims for breach/ seeking to set aside the contract. The viability of these claims will depend on the individual circumstances



What we don't know

Inherent technical risks

Crypto is a new technology with no central auditing system. The technology is moving very fast and attracts many of the world's most sophisticated hackers. Some platforms use no or very low security measures or checks and are the cause of their own downfall, so it is important to be able to carry out or have a partner who can carry out technical checks to see which platforms can be safely used. However, even the best intentioned of platforms do occasionally experience faults or technical vulnerabilities. Cryptoasset transactions can freeze mid transaction, wallets can stop working, and even many of the best regarded exchanges have been exploited. There are now institutional-grade solutions designed to offer the optimum safety.

How is crypto held by exchanges?

Are terms and conditions clear? If so, how do they describe the customers' ownership rights? Where the exchange is international, are ownership rights as described consistent with English law? Fundamentally, are customers of an exchange or custodian any more than unsecured creditors if it fails?

Bitcoin and other cryptocurrency mixers

Tornado Cash is an example. These are prime money obscuring and money laundering tools. While normally bitcoin and most other cryptocurrencies can be uniquely traced, mixers obscure and muddle coins so that what goes in doesn't go out! There is a risk to using mixers for their users (there's very little stopping the mixers from running off with the crypto) but there is very little we (lawyers, law enforcement or crypto analytics tools) can do about them.

Some decentralised (DeFi) wallets and exchanges – and uncooperative exchanges and wallets

Some cryptocurrency exchanges and wallets are operated on a decentralised basis, meaning that there is apparently no single individual or entity that is responsible. It is uncertain how insolvency law would apply to such a DEX or Defi wallet that failed; liability might in theory attach to the numerous participants, but if so, it could be difficult to enforce against them in practice. Other cryptocurrency exchanges, wallets and platforms simply won't cooperate with an insolvency procedure or will not have sufficient security and operational measures in place to do so. There is no guarantee that, if law enforcement reaches out to them regarding stolen cryptocurrency, they will act. This is especially true for platforms operating out of certain jurisdictions.

Crypto platforms are “distributed” firms

Some crypto firms do not disclose the jurisdiction of the entity that customers contract with because they believe that crypto should be a borderless technology. Some are incorporated in onshore jurisdictions, some offshore. Some are licensed and regulated, some not. Some operate in grey markets, some don't. The traditional point – know your counterparty – is critically relevant in crypto. Get support from service providers that answer these questions for you.

The intent of project founders

Some projects - crypto exchanges, wallets, initial coin offerings, companies – may look appealing from the outside but the founder or founding team might be building up to make enough money to run away with. This has happened several times and will happen again. There are tools that can identify technical failings and most of these risks. Some crypto projects have been successful at deceiving many intelligent people and companies, so you can't take too much care. Not all websites, claims and whitepapers are honest.



Who and what you need to know

It's who you know

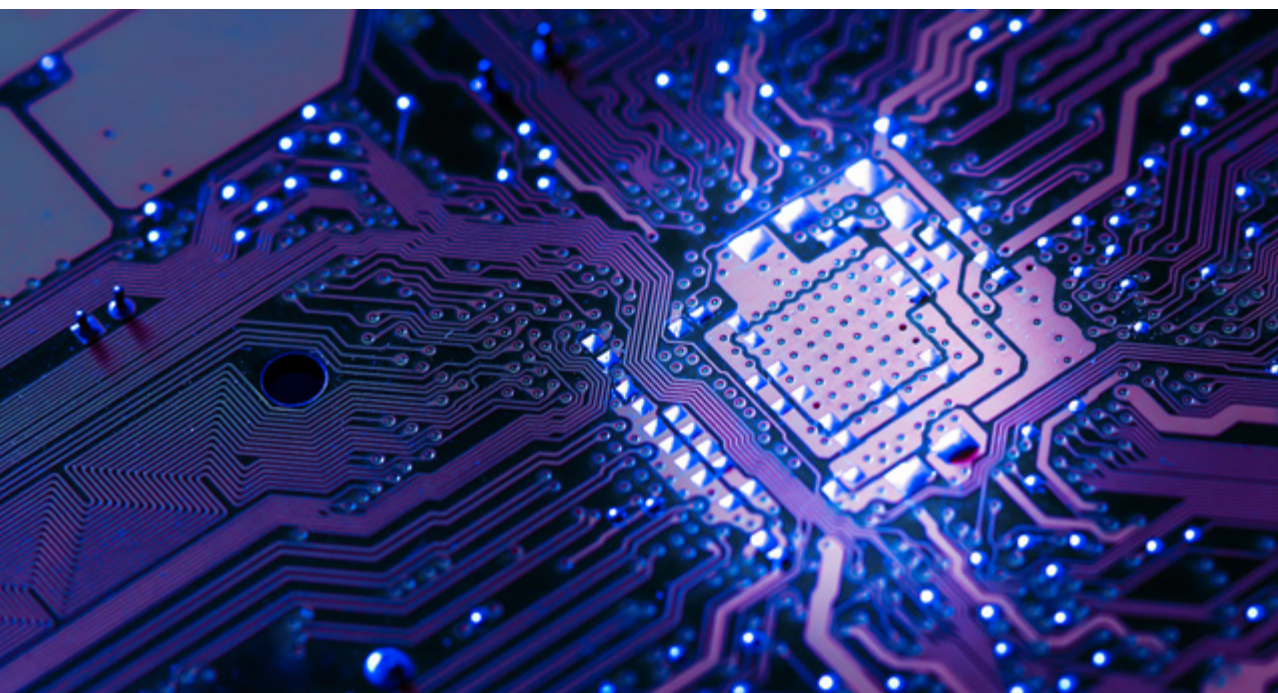
With crypto, a lot is down to having the right contacts and relationships in place to help you out when you need it. When crypto assets are hacked or stolen, having the appropriate person to call at an exchange or wallet who can ensure those stolen assets are frozen, can be the difference between getting your crypto back or losing it for good. Whilst it is possible to go through the Courts to get stolen crypto frozen, or even returned, doing so can take a long time. Your hacker or fraudster can move those assets in minutes. There is always the risk that they could quickly move crypto assets from a cooperative exchange to exchanges or wallets that won't cooperate or where they can't be frozen and where those funds are effectively lost for good.

Be prepared

It is important to have these relationships in place now, so that if crypto assets are stolen, it is possible to act as quickly as possible to get the relevant assets frozen. CMS has all of these relationships in place already so can make any calls, as needed.

Assume nothing

In crypto, unfortunately, trust cannot be assumed. If a company says that it will store crypto securely, or even send it back, that should not be assumed to be true. An understanding of how things like private keys, custody and smart contracts work is important and to be able to identify, from a technical as well as a legal perspective, whether they are good and safe. CMS is versed in the legal side and has technology partners to run these checks from a technical perspective.



Key relationships.

In that context, it is important to have relationships with the relevant people at the following types of firms:

Crypto Exchanges

(including Binance, FTX, Coinbase). There are many crypto exchanges. The biggest will tend to cooperate with law enforcement, or with requests to freeze funds if you already have those relationships in place.

Crypto wallets

these will allow you to hold and manage crypto yourself in circumstances where you cannot trust a third party custodian. Hot wallets such as MetaMask are connected to the internet so are less secure but more functional. The opposite is true of cold wallets such as the Nano USB device produced by Ledger.

Custody providers

such as Copper, Trustology and Ledger. These providers do their own KYC and AML checks, but it isn't impossible that stolen assets could slip through.

Chain analytics firms

Elliptic, Chainalysis, Ciphertrace, Merkle Science, Coinfirm, Blockchain Intelligence Group. These firms can help track crypto assets, spot trends, prevent fraud and identity and link illicit addresses. It's important to not only have access to some of their software but understand how they work and what they can do.

Law enforcement

As crypto is international, it can be essential to have relationships with the relevant international law enforcement agencies.

Crypto forensics investigators

These are experts at working with law enforcement and chain analytics firms to track cryptocurrencies.



Crypto at CMS

Specialist team

We are a large team of crypto lawyers and consultants, supported by crypto-knowledgeable lawyers in the restructuring and insolvency, wider finance, regulatory, disputes, funds, IP and corporate teams. We are the only UK law firm to employ a crypto industry business specialist to work with our lawyers on project validation, business models, networking and industry engagement. Our team has industry leaders including having Charles Kerrigan recognised as a leading influencer in the 2022 Blockchain Industry Landscape Overview.

Diverse client base

We act for over 100 cryptoasset clients, including exchanges, wallet providers, financial institutions, service providers, VC investors, hedge funds, protocols, DeFi projects, NFT issuers and platforms, DAOs and metaverse clients. We do transactional, advisory, fundraising, product launch, licence application, disputes, and consulting work for clients. We also support traditional clients on their digital assets projects, including accepting crypto payments, NFTs, Web3 development, sponsorship, partnering and metaverse.

Key partners

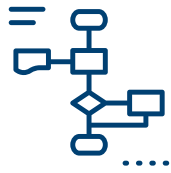
We have partnerships with firms providing all types of crypto asset services, including on and off ramps, chain analytics, smart contract auditing, blockchain development, digital asset custody, among many others.

At the forefront of policy

We advise the UK Parliament and Government on blockchain and crypto work and have been consulted by the UK Law Commission and the British Standards Institution on smart contracts and digital assets.

International reach

Our colleagues in Europe support us on projects in all leading crypto jurisdictions.



Restructuring & Insolvency at CMS

Team of experts

We are living in a time of unprecedented business risks. In the current climate, it is important for organisations to receive legal advice that will help them to avoid potential pitfalls and tackle challenges as they may occur. Our dedicated team of restructuring and insolvency lawyers provide solutions to a whole range of stakeholders involved in, or impacted by, financial restructuring and corporate insolvency situations.

Trusted advisers

From our extensive international platform, we provide pragmatic, business-focused advice and guidance to our clients. We have a strong track record of advising a broad spectrum of clients on national and international restructuring and insolvency and we are proven, trusted advisers to a range of clients, including listed and privately owned companies, insolvency office holders, financial advisers, boards of directors, banks, insurance companies, distressed debt funds, pension scheme trustees, regulatory bodies and turnaround specialists.

Creative and commercial

Successfully navigating what is often a complex landscape calls for creative and bold solutions from experienced practitioners. We understand the legal and business drivers involved when a company or counterparty gets into financial difficulties, and we have the technical skills and expertise to help achieve the best possible outcome.

Bench strength and global reach

As the largest law firm in Europe and sixth largest law firm globally, our team has the experience and capacity to deliver successful outcomes for clients wherever they do business. Few competitors can match the strength of our global platform, which allows us to quickly mobilise a team of experts from a range of legal disciplines, tailored to your specific needs.

Sector expertise

We are differentiated by world-class sector expertise with a focus on six core sectors – financial services; technology, media and telecommunications; energy, infrastructure and projects; life sciences and healthcare and real estate.



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CMS locations:

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