Cryptocurrencies in liquidation: Perspectives from Cayman and the BVI

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In this article, we consider how cryptocurrencies as a form of cryptoassets, rather than virtual assets generally, are characterised as a matter of law, and discuss the practical issues that liquidators are likely to face when seeking to realise these assets for the benefit of creditors.

Global investment in cryptocurrencies has increased exponentially in the last 12 months.

As of the first week of May 2021 the combined value of all crypto coins stood at an incredible US$2.43 trillion.

Not only has the market capitalisation of cryptocurrencies surged, the breadth of participants in the cryptocurrency markets has expanded, encompassing individuals, as well as retail and institutional investors. These investors span the global economies and it is this breadth and depth of cryptocurrencies in economies which make it necessary to consider how cryptocurrencies can be controlled, enforced against and realised in the context of corporate failures.

As centres of international finance these issues are increasingly relevant to disputes in the Cayman Islands and the BVI.

Nature of cryptocurrencies

Many lines of text have been written evaluating whether cryptocurrencies are capable of being classified as property as a matter of law, and capable of being owned with that ownership being transferred. This is a fundamental issue in the insolvency context.

As a matter of Cayman law the liquidators are empowered to collect in the *property* of the company, and it is the *property* of the company which is to be applied in satisfaction of its liabilities in accordance with the statutory priorities of the liquidation regime under sections 138 and 140 of the Cayman Islands' Companies Act.

Similarly, a principal duty of the liquidator of a BVI company is to take possession of, protect and realise the assets of the company under section 185 of the BVI Insolvency Act 2003. It is from the assets of a company that the costs and expenses of the liquidation process are to be paid.

If cryptocurrencies are not property or assets for the purposes of Cayman or BVI insolvency law, potentially valuable assets would not be available for the benefit of an insolvent company's creditors, or to fund the winding up process.

Given the jurisprudential similarities between England & Wales, the Caymans Islands and the BVI, it is instructive to consider the position under English law.

In November 2019 the UK Jurisdiction Taskforce (UKJTF), which is chaired by the Master of the Rolls Sir Geoffrey Vos, issued a Legal Statement on Cryptoassets and smart contracts, which expressed the view that cryptoassets were to be treated "in principle as property" as a matter of English common law.

This was the general view and recognised that each case will ultimately depend on "the nature of the asset, the rules of the system in which it exists, and the purpose for which the question is asked" (paragraph 15).

Considering the objectives of the English Insolvency Act 1986 (IA86), the UKJTF relied on the deliberately broad definition of "property" set out in section 436(1) of the IA86, to conclude that "since cryptoassets can be property at common law, we have no doubt that they can be property for the purpose of the [IA86]" (paragraph 109).

The English Courts have since held that cryptocurrencies are capable of being property for the purpose of seeking a proprietary injunction (see reference below for *Robertson v Persons Unknown*) and for the purposes of obtaining a Norwich Pharmacal order (*Science ION v Persons Unknown*).

The question is whether cryptocurrencies are property for the purposes of the insolvency regimes in the BVI and Cayman.

In the BVI this has been answered by the decision *Philip Smith and Jason Kardachi (in their capacity as joint liquidators of Torque Group Holdings Limited) v Torque Group Holdings Limited (in liquidation)*, where **Mr Justice Wallbank** held that cryptocurrencies were to be considered as an "asset" for the purposes of the BVI Insolvency Act 2003.

Torque Group Holdings Limited had operated as an online crypto-currency trading platform, providing users with trading and other services via their websites and mobile applications. Trading was suspended by Torque, after a number of unauthorised leveraged trades resulted in the Torque group of companies suffering losses, and facing claims from some 14,000 creditors. Philip Smith and Jason Kardachi of Borrelli Walsh were appointed as liquidators.

The liquidators identified that the majority of the assets of Torque were cryptocurrencies held in an account called the Tran Account on the online Binance Exchange,

The liquidators secured the Tran Account and applied to the BVI Commercial Court for directions that they convert the cryptocurrencies into US dollars or into Tether, being a cryptocurrency pegged to the US dollar. The estimated book value of the cryptocurrencies had fallen by some 28% since the liquidator's initial, provisional, appointment. The purpose of the court application was therefore to safeguard the value of the company's assets from market volatility, going forwards.

The first question was whether the cryptocurrencies in the Tran Account were to be regarded as an asset for the purposes of the BVI Act.

Wallbank J referred to the definition of "asset" set out in the BVI Act which states that an asset includes "money, goods, things in action, land and every description of property wherever situated and obligation and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property". The definition attributed to assets under the BVI Act is that same definition which is given to property in section 436(1) of the IA1986. Accordingly, Wallbank J invoked the reasoning set out in the Legal Statement in respect of section 436(1) of the IA1986 to hold that cryptocurrencies qualify as assets for the purposes of liquidation under BVI law (*Torque* [21]-[26]).

In Cayman the Grand Court has not yet been called on to consider if cryptocurrencies are property for the purposes of the winding up provisions of the Companies Act, and the Companies Act does not contain a definition of property or assets which is peculiar to the winding up provisions set out in Part V – there is a circular definition of "property" set out in section 87 of the Companies Act, which is specifically applicable to the scheme of arrangement jurisdiction but that is not applicable to the winding up provisions.

However, the Interpretations Act provides a definition of property that is in the exact terms of the definition of property in the IA86, and of assets in the BVI Act. Accordingly subject to judicial pronouncement on the issue, as a matter of Cayman law cryptocurrencies are likely to fall within the definition of property generally and not only for the purposes of liquidation.

Determining ownership

On the basis that cryptocurrencies are property or assets capable of forming part of a liquidation estate, it is for a liquidator to collect in and realise those assets that belong to the company.

This question of ownership was also addressed by Wallbank J in *Torque* where the cryptocurrencies were held in two categories of private wallet.

The first category were cryptocurrencies over which Torque had exclusive control and knowledge of the private keys which granted access to the wallets. The second were cryptocurrencies over which Torque did not have control and had no knowledge of the private keys, but merely provided access to an exchange platform for the underlying wallet users.

In accordance with the views of the UKJTF on the question of ownership, the court held that only the first category were assets of the company for the purposes of the liquidation (*Torque* [27]-[32]). The assets in the second category would fall outside the liquidation on the basis that they are not assets of Torque, and rather the property of the individual users of those wallets.

Collecting in cryptocurrencies

Novel issues come up when considering how cryptocurrencies owned by a company can be collected in and realised by a liquidator.

The first step is to ascertain if the company has any investments in cryptocurrencies. This is likely to require a review of the company's books and records. Confirmation of holdings in cryptocurrencies could be set out in board minutes, or indicated in bank statements showing a fiat currency entry (on-ramp) into a cryptocurrency system.

To collect in these assets it is essential for the liquidators to have both knowledge and control of the private key for any wallet owned by the company. In an ideal world the private key would be stowed safely in a company safe. However, it is likely to be the case that the private key is in the control of one member of management who may no longer be cooperative.

In this scenario, the liquidator may need to consider whether that person could be summoned to provide an account of the affairs of the company, and to produce documents and property belonging to the company, under the powers contained in section 103 of the Cayman Islands' Companies Act; sections 282 to 283 of the BVI Insolvency Act (examination by office holder); and sections 284 to 288 of the BVI Insolvency Act (examination by the court).

Interestingly, a private key alone is not regarded as property in the Legal Statement because it is "information2 (paragraph 85(e)). It follows that consideration will need to be given under BVI and Cayman law as to how a private key should properly be

characterised to enable liquidators to collect in cryptocurrencies which are property or assets.

Antecedent transactions are a means of collecting in the assets of a company in both Cayman and BVI liquidations under sections 145 to 147 of the Cayman Companies' Act, and sections 244 to 252 of the BVI Insolvency Act. An issue that liquidators will need to overcome is the ability to clawback assets where the recipient cannot be identified.

The recognition in the English Courts that freezing orders may be made in respect of cryptocurrencies demonstrates that these assets are equally capable of being subject to legal concepts of tracing and following, and it is likely to be a question of deploying the right technology to clawback cryptocurrencies.

While cryptocurrency is still a relatively new frontier, recognising that it is an asset or form of property in the liquidation context goes a long way to demystifying this asset class.

But the question of how any one cryptocurrency can be collected and realised by liquidators will depend on each scenario, so liquidators navigating these issues should seek legal advice to work through the novel but not insurmountable issues that arise.

Case references

Robertson v Persons Unknown Unreported, 16 July 2019, (Commercial Court)

Science ION v Persons Unknown BVIHC (Com) 0031 of 2021

Philip Smith and Jason Kardachi (in their capacity as joint liquidators of Torque Group Holdings Limited) v Torque Group Holdings Limited (in liquidation) BVIHC (Com) 0031 of 2021

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