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Voyager: The Convergence of Chapter 11 and the Crypto Winter

Update

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Voyager Digital Assets, Inc., a leading cryptocurrency brokerage and lending platform, filed for Chapter 11 bankruptcy protection on July 5, 2022 in the Southern District of New York following a recent financial crisis impacting the crypto industry, which investors are calling the "crypto winter." The filing was followed by the Chapter 11 bankruptcy of Celsius Networks. While the situation is fluid, these two filings could be the beginning of a series of bankruptcies by major cryptocurrency companies. As global financial markets worsen and investors withdraw their assets – particularly in the riskier field of cryptocurrency – more companies may be forced to seek refuge in bankruptcy, raising novel issues for courts tasked with distributing digital assets to creditors.

Because Voyager is the first cryptocurrency company to file for Chapter 11, new law will quickly develop in the bankruptcy proceeding that will have a lasting impact on the cryptocurrency industry, and winners and losers will emerge based on the actions parties take now during these uncertain times. Here at Bracewell, we have vast experience in restructuring representing debtors, equity owners, creditors, ad hoc groups, creditors' committees, asset purchasers and other distressed investors. We have combined our expertise in restructuring and crypto to form a team of lawyers who are focused on the issues interested parties should know about to protect their interests and take advantage of the current market both in and outside of bankruptcy.

According to historical balance sheet data, Voyager's financial struggles were somewhat abrupt and stand in stark contrast to prior year results. Voyager had a strong fiscal year in 2021, due in large part to an increase in customer deposits that the company used to provide loans to counterparties in the crypto sector. These intra-industry loans are common in the crypto world, and in good times, were used to pass off any interest earned on the loans directly to customers. However, as the underlying value of digital assets fell in recent

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months and customers withdrew their assets, counterparties defaulted on the loans, leading to a cascading financial crisis.

In a recent press release, Voyager cited general market conditions as well as a defaulted $650 million loan to Three Arrows Capital – a crypto hedge fund that recently struggled and is itself undergoing insolvency proceedings in the British Virgin Islands and a corollary Chapter 15 bankruptcy in the Southern District of New York. Voyager's Chief Executive Officer Stephen Ehrlich expressed high hopes for the company's future, but noted that Voyager's objective for a "comprehensive reorganization is the best way to protect assets on the platform and maximize value for all stakeholders, including customers."

Voyager has recently proposed a Chapter 11 plan of reorganization to emerge from bankruptcy, along with a potential sale process. Through the proposed plan, Voyager seeks to distribute a combination of crypto held on the Voyager platform, shares of the newly reorganized company, Voyager tokens, and proceeds from the Three Arrows recovery to customers. The company disclosed that is has $110 million in cash and crypto assets on hand as well as $1.3 billion of crypto assets on its platform. It also has more than $350 million of cash held in a For Benefit of Customers account at Metropolitan Commercial Bank. In contrast to customers' digital assets on the Voyager platform that the company considers property of the bankruptcy estate – a position that is likely to be hotly contested in the proceedings – Voyager has promised immediate return of the $350 million to customers following completion of a reconciliation and fraud prevention process by the bank. Despite these assets, as an unsecured creditor in the Three Arrows bankruptcy, Voyager's successful reorganization and confirmation of the plan will ultimately depend on the amount it recovers from the ongoing Three Arrows liquidation.

Voyager has announced that it is exploring all options to maximize customer recoveries, including a dual-track restructuring process which could lead to the sale of the company in place of distribution under the proposed plan. On July 21, Voyager filed a Bidding Procedures Motion requesting initiation of a confidential bidding process prior to confirmation of the plan and has engaged with more than 80 interested parties. Although it is possible that a winning bid would replace the proposed distribution of assets to customers, Voyager makes clear that its preference is for a sale that can be accomplished through the proposed plan.

The Voyager bankruptcy raises novel issues concerning the distribution of digital assets under the Bankruptcy Code. At the Voyager first day hearing, the court questioned whether digital assets on the Voyager platform should be considered property of the estate, and thus subject to distribution to unsecured creditors, or property of Voyager customers themselves. The answers to these novel questions are likely to come soon, as the Southern District of New York wades into the substance of the Voyager and Celsius Network bankruptcies.

The answers will ultimately determine the success of reorganization by these, and other companies forced into bankruptcy by the crypto winter.