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Celsius Earn Depositors May Be Left Cold by Crypto Ownership Ruling

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The “crypto winter” of 2022 brought a bear market and a recent wave of bankruptcies to the crypto industry, leaving some retail customers of crypto exchanges frozen out of their accounts. As the bankruptcy filings mounted from Voyager Digital and Celsius Network (“Celsius,” or the “Company”) to FTX US and BlockFi, lawyers, industry experts, market participants and retail customers wondered alike – who owns the cryptocurrency stored on a debtor’s platform in the event of a bankruptcy? Although limited to the specific terms of the customer agreements at issue in Celsius, Judge Martin Glenn issued a ruling in the Celsius bankruptcy proceedings giving an initial indication as to how this inquiry may be assessed.[1]

On the date of its bankruptcy filing, Celsius had approximately 600,000 accounts in its “Earn” program (the “Earn Accounts”). The Earn program allowed customers (the “Depositors”) to deposit cryptocurrencies on the Celsius platform and receive from the Company as much as 18% interest annually. The Earn Accounts at Celsius held approximately $4.2 billion in cryptocurrency assets as of July 10, 2022, including $23 million worth of stablecoins. From the beginning of the Celsius bankruptcy proceedings, the Depositors advocated that cryptocurrencies held on the Celsius platform should be returned to them as quickly as possible. However, with respect to Earn Accounts, the Company took the position that the Celsius terms of use (the “Terms of Use”) unambiguously provide that all rights to such cryptocurrencies, including ownership rights, belong to the Company. The issue

came to a head when the Company brought a motion seeking to sell certain of the stablecoins held in the Earn Accounts.

Judge Glenn's 45-page decision agreed with the Company, and overruled objections supported by hundreds of individual Depositors, as well as the objections of a number of governmental entities, including the Texas State Securities Board and the United States Trustee. Judge Glenn determined that the $4.2 billion in cryptocurrency deposited by customers into the Earn Accounts belongs to the Company – not the depositors. As a result, the Company can sell or exchange the stablecoins held in Earn Accounts in the ordinary course of business to fund the Company's operations and pay the expenses of the bankruptcy case.

A Dispute over Ownership of Crypto-Assets

On September 15, 2022, the Company filed a motion seeking authority to, among other things, sell a portion of the cryptocurrency held in the Earn Accounts (the "Stablecoin Sale Motion") to fund its bankruptcy case, which lead to a spate of objections falling into two broad categories:

- Several state regulators contended that any ruling on the ownership of the Earn Assets should come after the Celsius chapter 11 examiner completes its report.[2] The regulators argued that until then it is not clear how ownership of the Earn Assets could have been transferred to Celsius. Moreover, several state regulators argued that the Company is under investigation for marketing securities without necessary registrations and without complying with state regulatory frameworks and federal law, and therefore cannot rely on the arguably unlawful Terms of Use to determine the purported ownership of these assets.

- The objecting Depositors argued, among other things, that the Terms of Use relied on by Celsius were actually ambiguous, as they use the terms "loan" and "lending" which would mislead a layperson to believe that title and ownership remained with the customer. The account holders also argued that they have defenses to contract formation and modification, as well as breach of contract claims against Celsius that should prohibit the Company from claiming ownership of the crypto deposited.

In support of the Stablecoin Sale Motion, Celsius argued that 99.86% of Depositors accepted the Terms of Use through a "clickwrap contract",[3] and thereby agreed that Celsius held "all right and title to such Eligible Digital Assets, including ownership rights" in the cryptocurrency in question.

The Celsius Terms of Use at issue provide:

Assets using the Earn Service . . . and the use of our Services, you grant Celsius . . . all right and title to such Eligible Digital Assets, including ownership rights, and the right, without further notice to you, to hold such Digital Assets in Celsius' own Virtual Wallet or elsewhere, and to pledge, re-pledge, hypothecate, rehypothecate, sell, lend, or otherwise transfer or use any amount of such Digital Assets, separately or together with other property, with all attendant rights of ownership, and for any period of time, and without retaining in Celsius' possession and/or control a like amount of Digital Assets or any other monies or assets, and to use or

invest such Digital Assets in Celsius' full discretion. You acknowledge that with respect to Digital Assets used by Celsius pursuant to this paragraph:

1. You will not be able to exercise rights of ownership;
2. Celsius may receive compensation in connection with lending or otherwise using Digital Assets in its business to which you have no claim or entitlement; and
3. In the event that Celsius becomes bankrupt, enters liquidation or is otherwise unable to repay its obligations, any Eligible Digital Assets used in the Earn Service or as collateral under the Borrow Service may not be recoverable, and you may not have any legal remedies or rights in connection with Celsius' obligations to you other than your rights as a creditor of Celsius under any applicable laws.[4]

The Terms of Use Are a Valid, Enforceable Contract That Transferred Title and Ownership of the Assets in the Earn Accounts to Celsius

The bankruptcy court noted that the requirements for contract formation are no different for electronic contracts than they are for more traditional pen-and-paper agreements, as courts have "adapted traditional principles of contract formation to fit the digital era." This is the case even where, as in Celsius, a "clickwrap" agreement does not necessarily require the account holder to *actually* view the terms of use, and may contain provisions allowing for the company to unilaterally modify its terms.[5]

Using traditional contract analysis, the Celsius court found that mutual assent, consideration, and intent to be bound – the elements of a valid, enforceable contract – were present. The Court recognized that (i) the Depositors manifested assent and intent to be bound by clicking that they accepted the Terms of Use and (ii) that New York Courts overwhelmingly accept such "clickwrap" agreements. As such, the court held that the Depositors unambiguously transferred title and ownership of the Earn assets to Celsius pursuant to the plain language of the Terms of Use, regardless of how those terms may have been understood.[6]

The court also addressed the argument of certain objecting Depositors that the crypto assets held in the Earn Accounts were merely *loaned* to the Company. The court observed that even if these assets were loaned to Celsius, such loans would create a traditional creditor-debtor relationship between the parties where Celsius maintains possession of the assets, and the Depositor has a claim to payment. Under such circumstances, Depositors would still be unsecured creditors unless they held a perfected security interest in the property. However, the court recognized that digital assets such as crypto generally are regarded as a general intangible upon which a lien may be perfected only by the filing of a financing statement. Finding that "the Terms of Use . . . [make] it very clear that no ownership interest or lien in favor of the Account Holders was intended . . . [a]nd certainly no lien in favor of the Account Holders was perfected," the court held that the "clear and consistent" Terms of Use granted Celsius all right and title to the assets in the Earn Accounts.

Judge Glenn's decision makes clear, however, that the Depositors have not been left empty-handed:

To be clear, this finding does not mean holders of Earn Assets will get nothing from the Debtors. Account Holders have unsecured claims against the Debtors in dollars or in kind (depending on the terms of any confirmed plan). The amount of allowed unsecured claims is subject to later determination in this case (through the claims allowance process) and may potentially include damages asserted by Account Holders, including breach of contract, fraud or other theories of liability. . . .

The Court takes seriously potential violations of state law and non-bankruptcy federal law, as well as the litany of allegations including, but not limited to, fraudulent inducement into the contract, fraudulent conveyance, breach of contract, and that the contract was unconscionable. These allegations may (or may not) have merit, and the creditors' rights with respect to such claims are explicitly reserved for the claims resolution process. But importantly, as a prerequisite to those claims, the Court first must establish that a contract was formed and must interpret the contract terms.

Stablecoin Sales & Chapter 11 Funding

After his findings on ownership, Judge Glenn held that the Company had made a sufficient showing to sell the stablecoins held in the Earn accounts. Judge Glenn's decision on this point seemed premised on the fact that time is not a luxury the Company possesses:

A rare point of agreement among all parties is that the Debtors' liquidity is precipitously running out. The Debtors need to generate liquidity to fund these Chapter 11 cases and continue down the path either of a standalone plan [of] reorganization, a section 363(b) sale, or even a liquidation plan. The Debtors project that additional liquidity will be needed in early 2023. The Debtors demonstrate a sound business justification for selling stablecoins, and the Court agrees that it is appropriate to [grant] authority to do so.

Thus, the Company will be permitted to sell stablecoins held in the Earn Accounts to continue funding the bankruptcy cases.

Critical Crypto Ownership Issues Remain Open

Although Judge Glenn's decision is specifically limited to the customer agreements in Celsius, he continues to blaze judicial trails in the crypto bankruptcy space.[7] Participants, customers and others in the crypto industry should take note of how Judge Glenn analyzed the Terms and Conditions in Celsius, as careful analysis of contractual language will be critical to the outcome of future crypto ownership disputes. It is clear that other substantial issues remain to be resolved in the crypto "winter of our discontent."

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[1] *In re Celsius Network LLC*, Case No 22-10964(MG), 2023 WL 34106 (Bankr. S.D.N.Y. Jan. 4, 2022).

[2] An examiner was appointed in the Celsius case to investigate various issues arising from the Company's prepetition operations such as: (i) where the

cryptocurrency was stored, (ii) whether the cryptocurrency was commingled, (iii) the procedures for paying taxes and complying with other non-bankruptcy law, and (iv) the status of utility obligations relating to the Company's mining operations.

[3] *See Plazza v. Airbnb, Inc.*, 289 F. Supp. 3d 537, 548 (S.D.N.Y. 2020) ("Clickwrap agreements are generally defined by the requirement that Account Holders 'click' some form of 'I agree' after being presented with a list of terms and conditions").

[4] *Celsius*, 2023 WL 34106, at * 4.

[5] There were multiple versions of the Terms of Use (versions 1 through 8), though the court determined that 90% of account holders representing 99% of the assets held in Earn Accounts had assented to version 6 or later. The Terms of Use, beginning with version 1, provide that (1) the Company can unilaterally modify the Terms of Use without notice, and (2) the account holders' continued use of the platform following an update constitutes consent to the amended Terms of Use. *Id*. at *16. Accordingly, the court found that the account holders were bound by the language from version 8 of the Terms of Use, including the excerpt above. *Id*. at 17.

[6] Judge Glenn's decision noted that although a number of objectors argued that Celsius modified the Terms of Use through advertisements and media uploaded to the Company's social media channels, such media was not submitted to the court as evidence. *Id*. The decision further notes that even if this media was submitted as evidence, advertisements and other similar statements "generally do not constitute offers, and an offer is a necessary predicate for any 'amendment' to the Terms of Use." *Id*.

[7] https://www.cadwalader.com/resources/clients-friends-memos/quantifying-cryptocurrency-claims-in-bankruptcy-does-the-dollar-still-reign-supreme