Crypto-currencies in insolvency proceedings in France: How to deal with highly volatile assets?

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Born in the early 2010's, crypto-assets are real UFOs in the French legal landscape. Defined by French Monetary and Financial Code as "*any instrument containing in digital form non-monetary value units that may be retained or transferred in order to acquire a good or service but that does not represent a claim towards the issuer*", these crypto-assets refer in practice to two types of digital assets:

Article L.561-2 of French Monetary and Financial Code

- Cryptocurrencies, the creation of which is operated by so-called "*Blockchain*" technologies; and
- Tokens, issued by companies using digital fundraising, more commonly known as Initial Coin Offerings (ICOs).

Initially designed as a trade instrument in the digital environment, crypto-assets have gradually gained ground in the real economy thanks to services allowing them to be purchased or sold in exchange for national currencies, to be stored, or to be used as a financing instrument within an ICO.

There are now nearly 1,600 crypto-currencies in circulation. Three of them, namely *Bitcoin*, *Ethereum* and *Ripple*, dominate digital transactions and capitalizations. Considering the rise of digital assets, worldwide regulators and legislators must implement in a coordinated way an appropriate legal framework for these peculiar assets.

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In this respect, French legislators have attempted to be pioneers: they allowed in France the use of "*Blockchain*" technologies for the transmission of unlisted financial securities and minibons, and have recently focused on the legal framework of ICOs and the taxation of crypto-assets. It seems that French legislators do not intend for now to adapt French insolvency proceedings to the processing of digital assets. However, given the growing success of crypto-assets, insolvency proceedings might be open soon against French companies holding digital assets.

Ordinances No. 2017-1674 of 8 December 2017 and No. 2016-520 of 28 April 2016 on the "shared electronic recording device" and the implementing decree of 24 December 2018

Consequently, we will be conducting hereafter an analysis of the legal qualification of crypto-currencies and their handling within insolvency proceedings, through practical situations arising in French insolvency law.

Bill on the action plan for the growth and transformation of companies, known as "PACTE".

Finance Law 2019

1. The legal qualification of crypto-currencies and its consequences

1.1 Crypto-currency, an available asset pursuant to Book VI of French Commercial Code?

The concept of "cash-flow insolvency" is the cornerstone of French insolvency law. This key issue is used as a barometer to evaluate the severity level of financial difficulties encountered by a company and determines the appropriate procedure that should be opened for such company.

It has to be noted that French law does not know the German concept of “overindebtedness” and defines as sole opening ground as cash-flow test.

From a legal point of view, a cash-flow insolvent company is a company which is "*unable to meet its debts as they fall due with its **available assets***". Detecting a cash-flow insolvency therefore requires an isolated and precise evaluation of the available assets of the company facing financial difficulties.

Articles L. 631-1 and L. 640-1 of French Commercial Code

In this context, should crypto-currencies held by a company facing financial difficulties be apprehended as available assets?

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Company's "available assets" include (i) all liquidity and (ii) assets immediately to be disposed of, i.e. any asset that can be easily and quickly converted into monies, such as due commercial bills and publicly-listed securities. In practice, crypto-currencies, like listed securities, have a "store-of-value" function and can be immediately converted into monies following their sale at market price on dedicated trading platforms. They may also be resold on so-called escrow platforms, which directly connect purchasers and sellers.

In our opinion, crypto-currencies should thus be taken into account in the valuation of the company's available assets.

Consequently, digital assets might "inflate" available assets, allowing the company facing financial difficulties to temporarily escape from the cash-flow insolvency. However, if a company's available assets are largely composed of crypto-assets, the slightest fluctuation in their value may suddenly lead to a cash-flow insolvency, meaning that legal representatives must be very vigilant regarding their legal duties. Indeed, as long as a company has enough liquidity to cover its current expenditures, it will not be cash-flow insolvent, despite the fact that the company's assets are significantly impaired at a given time.

1.2 Crypto-currency, intangible asset or 'real' currency?

Creditors of the company have to file, during the legal time limits, their due claims to the appointed creditors' representative. This proof of claim must be expressed in euros or in a foreign currency, in which case it shall be converted at the exchange rate prevailing on the date of issue of the order opening insolvency proceedings.

In this context, can crypto-currencies be assimilated to foreign currencies, so that they could be used in a file of claim?

In particular, cash, credit balance of bank accounts, commercial bills payable on demand, credit reserves or standstill granted by creditors

For example, the website coinbase

For example, the website LocalBitcoins.com

For instance, a company running a specialized crypto-currency exchange platform

In particular with regard to their legal duty to file for insolvency proceedings within a compulsory 45-days period as from the date of cash flow insolvency (Article L. 631-4 of French Commercial Code)

Article L. 622-25 of French Commercial Code

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The majority of French legal authors are of the opinion that crypto-currencies cannot constitute an official currency which is legal tender, since such assets are not state-related and do not benefit from any official recognition. The many reports issued by French and European regulatory authorities agree and consider that crypto-currencies do not "*fulfil or only partially fulfil*" the three traditional functions of money. In our opinion, the French judges who will have to settle for the first time the legal qualification of crypto-assets may be inspired by the decision of a Californian court rendered on January 22, 2016, which had ruled that Bitcoin is not a currency but an asset.

ESMA, ACPR, AMF, Banque de France, Focus n°16 "The emergence of bitcoin and other crypto-actives: challenges, risks and prospects", 5 March 2018

US Bankruptcy Court Northern District of California, Case n°14-30725, Aff. Hashfast c/ Mark Lowe

Qualifying crypto-assets as **intangible assets** has several other consequences.

The owners of crypto-currencies might consider these assets as a means for the granting of a security. However, in our view, granting a security on these complex assets is hardly practicable. For instance, the granting of a so-called 'non-possessory' pledge ("*nantissement sans dépossession*") on crypto-currencies would offer a very weak guarantee to the secured creditor, assuming that the pledge is validly granted. Similarly, the granting of a so-called 'possessory pledge' would require the transfer of the pledged crypto-currencies into the hands of the secured creditor or a third party, causing significant practical difficulties. More generally, the complexity and very high degree of value fluctuation of these assets would constitute a real source of uncertainty for the creditor when enforcing the guarantees.

Under French law, a non-possessory pledge ("nantissement sans dépossession") is a security that does not transfer the possession of the pledged asset into the hands of the secured creditor

However, it is worth considering whether crypto-currencies can be subject to a title clause, so that they could be claimed by a creditor who considers himself as the true owner. To this end, the creditor will have to prove that there has been no transfer of ownership of the crypto-currencies to the debtor company as a result of their non-payment or only partial payment.

A non-possessory pledge will be enforceable against third parties, provided that it is published on the specialized French register

In our opinion, such a scenario cannot exist in practice. Blockchain technology allowing the circulation of crypto-currencies leads *de facto*

Except for stable crypto-currencies, such as "stable coin"

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to a transfer of ownership, so that it should not allow the provision of a title clause or a deferred payment of the transferred digital assets.

As a result, a debtor company holding crypto-currencies would necessarily have full ownership of them.

2. The processing of crypto-currencies during insolvency proceedings

2.1 Before the opening of insolvency proceedings: How should the manager deal with crypto-currencies?

In order to prevent the debtor company from squandering its assets to organise its insolvency, or to unduly favour certain creditors at the expense of others, the principle of the so-called "claw back period" has been introduced into French law. The court-appointed bodies in charge of judicial reorganisation or liquidation proceedings may request the cancellation of certain suspicious acts occurred during this period in order to restore the assets of the debtor company as they were before the occurrence of the disputed acts.

Period between the date of cash-flow insolvency and the date of issue of the order opening insolvency proceedings

Therefore, could transactions carried out in crypto-currencies within the claw back period be challenged?

Two scenarios can be considered separately: payments made in crypto-currencies and the conversion of crypto-currencies into monies during the claw back period.

Article L. 632-1 of French Commercial Code

According to French law, shall be considered null and void any payments for debts due, through any means other than cash, commercial bills, bank transfer, assignment slips or **any other payment means commonly accepted in business relations** when occurred during the claw back period.

We can reasonably consider that, to date, transactions made in crypto-currencies do not (yet) constitute a "*commonly accepted payment means in business relationships*". Consequently, from a strictly legal

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point of view, payments made in crypto-currencies during the claw back period could be challenged.

From a practical point of view, we may wonder whether such a challenge is appropriate, considering the high degree of value fluctuation of crypto-currencies. Indeed, between the occurred payment and the moment when the digital assets are returned to the seller as a result of the cancellation of the challenged transaction, the value of such assets may have increased or decreased significantly.

To the contrary, by interpreting the laws in force, conversions of crypto-currencies into monies may not be challenged during the claw back period. However, a manager well aware of the approaching difficulties who would quickly sell the company's crypto-currencies for a low price could be held personally liable. Indeed, it is likely that this manager could be held liable personally for any shortfall assets, since this poor conversion operation could constitute a mismanagement leading to increase the liabilities of the company facing financial difficulties.

2.2 During insolvency proceedings: How the insolvency practitioner should handle crypto-currencies? Valuation difficulties for a purchaser.

During insolvency proceedings, the key issue is the valuation of crypto-currencies.

If safeguard or judicial reorganisation proceedings are opened, the debtor company's business continues within the framework of a so-called "observation period". In order to create cash flows highly valuable to finance the company's continued business, the insolvency administrator may sell the crypto-currencies. To do so, he/she would need the cooperation of the legal representatives of the debtor company, who should give him/her access to the various storage methods of the crypto-currencies held by the company.

We may wonder whether the insolvency administrator could be held liable if he/she resells the crypto-currencies held by the debtor

- In order to build a detailed assessment of the company's financial situation and to seek necessary restructuring measures
- With the authorization of the supervisory judge
- For example, a USB key ("Hard Wallet") or digital keys allowing access to a dematerialized portfolio

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company at a low price (at the expense of the insolvency proceedings) in order to quickly obtain cash.

However, this risk appears us as theoretical as long as the insolvency administrator has previously been granted the insolvency judge's authorisation to proceed with the sale of the crypto-currencies.

When a company is subject to judicial reorganisation or liquidation proceedings, two exit scenarios may be considered: the global or partial sale of the business and/or the isolated disposal of the various assets held by the company.

In the context of a global or partial sale, purchasers will have to propose a purchase price to the Court, taking into account, among other things, the value of the held digital assets. However, given their high volatility, it is very likely that the value of crypto-currencies might change between the submission of the purchaser's offer and the order rendered by the Court deciding on the sale. Consequently, since the submitted offers cannot be amended until the Court's ruling, the purchasers will have to support the risk of crash in value of the crypto-currencies occurred prior to the order deciding on the sale.

In the context of isolated disposals of the debtor company's assets, the issue linked to the crypto-assets' valuation may not arise thanks to the insolvency judge, who must (or not) authorise the sale of crypto-currencies by public auction, or through private sales at the price and conditions he early determines. Under these circumstances, the value of crypto-currencies would be debated at the public auction, or may be determined at an early stage by the insolvency judge.

In sum, French insolvency law shows a certain rigidity which is inconsistent with the high degree of value fluctuation of crypto-currencies. In order to anticipate the first French insolvency proceedings processing crypto-currencies, bankruptcy practitioners will have to educate themselves to safely handle these very peculiar assets.

Except in a more favourable direction

Key points

Crypto-currencies are most likely intangible assets.

They must be taken into account in the valuation of the company's available assets.

No filing of claims to the estate in crypto-currencies.

Every payment made by means of crypto-currencies during the clawback period should be void.

The high degree of value fluctuation of crypto-currencies is a new challenge for actors in insolvency situations.

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