Crypto-currencies in insolvency proceedings in France: Dealing with highly volatile assets

Anja Droege Gagnier and Léa Marlière explain how the new technologies are handled in France

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Born in the early 2010's, crypto-assets[1] 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 Initial Coin Offerings (ICOs).

There are now nearly 1,600 crypto-currencies in circulation. Three of them, namely *Bitcoin*, *Ethereum* and *Ripple*, dominate digital transactions and capitalisations.

Considering the rise of digital assets, worldwide regulators and legislators must implement in a coordinated way an appropriate legal framework for these peculiar assets. 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[2], and have recently focused on the legal framework of ICOs and the taxation of crypto-assets[3]. It seems that the French legislators do not consider for now the issues relating to the legal qualification of crypto-currencies and their handling within insolvency proceedings.

The legal qualification

Crypto-currency, an available asset?

Acting as a barometer to evaluate the severity level of financial difficulties encountered by a company, the concept of "cash-flow insolvency"[4] and its detection require an isolated and precise evaluation of the available assets of the distressed company. The company's 'available assets' include all liquidity and immediately realisable assets. In practice, crypto-currencies have a "store-of-value" function and can be immediately converted into monies following their sale at market price on dedicated trading platforms, so that they 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 the legal representatives must be very vigilant regarding their legal duties.

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

The creditors of a company may be tempted to file their due claims to the creditors' representative in crypto-currencies, which would then be assimilated to a foreign currency.

The many reports issued by French and European regulatory authorities agree and state 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[5]. Consequently, a claim cannot be expressed in crypto-currencies when filed.

The owners of crypto-currencies might consider these assets as a means for granting a security. However, granting a security on these complex assets is hardly practicable. For instance, the granting of a so-called 'non-possessory' pledge ("*nantissement sans dépossession*")[6] on crypto-currencies would offer a very weak guarantee to the secured creditor, assuming that the pledge is validly granted[7]. Similarly, the granting of a so-called 'possessory pledge' ("*nantissement avec dépossession*") 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 source of uncertainty for the creditor when enforcing the guarantees.

In this respect, can crypto-currencies be subject to a title clause, so that they could be claimed by a creditor who considers himself as the true owner? Such a scenario cannot exist in practice. Blockchain technology allowing the circulation of crypto-currencies leads de facto to a transfer of

ownership, in such a way 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.

The processing

Before the opening of insolvency proceedings

Two scenarios can be considered separately: payments made in crypto-currencies and the conversion of crypto-currencies into monies during the clawback period[8].

Payments made in crypto-currencies during the clawback period could be challenged, as transactions made in crypto-currencies do not (yet) constitute a "*commonly accepted payment means in business relationships*"[9]. However, such a challenge would not be relevant, considering that the value of the crypto-currencies may have increased or decreased significantly between the occurred payment and the moment when these assets are returned to the seller as a result of the cancellation of the challenged transaction.

To the contrary, conversions of crypto-currencies into monies may not be challenged during the clawback 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 for any shortfall of assets, since this conversion could be considered as mismanagement, leading to increasing the liabilities of the company facing financial difficulties.

During insolvency proceedings

In order to create cash flows highly valuable to finance the company's continued business in the "observation period"[10], 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.

Could the insolvency administrator be held liable if he/she resells the crypto-currencies held by the debtor company at a low price (at the expense of the insolvency proceedings) in order to quickly obtain cash? This risk seems excluded as long as the insolvency administrator has previously been granted the insolvency judge's authorisation to proceed with the sale of the crypto-currencies.

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 crypto-currencies. However, since the submitted offers cannot be amended until the Court's ruling (except in a more favourable direction), the purchasers will have to assume the risk of a crash in the value of the crypto-currencies, occurred prior to the Court 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 authorises (or not), the sale of crypto-currencies by public auction or through private sales, at the price and conditions he earlier 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 summary, 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 train themselves to safely handle these very peculiar assets. ■

Footnotes:

1 Crypto-currencies and tokens
2 Ordinances of 8 December 2017 and 28 April 2016 on the "shared electronic recording device" and the implementing decree of 24 December 2018
3 "PACTE" (plan for the growth and transformation of companies) Law of 11 April 2019 and Finance Law 2019
4 In France, cash-flow insolvency is the sole factor allowing the opening of insolvency proceedings (judicial liquidation and reorganisation proceedings), pursuant to Articles L.631-1 and L.640-1 of the French commercial Code
5 ESMA, ACPR, AMF, Banque de France, Focus n°16 "*The emergence of bitcoin and other crypto-actives: challenges, risks and prospects*", 5 March 2018
6 Under French law, a non-possessory pledge is a security that does not transfer the possession of the pledged asset into the hands of the secured creditor
7 The pledge will be enforceable against third parties, provided that it is published on the specialised French register
8 In France, period between the date of cash-flow insolvency and the date of issue of the order opening insolvency proceedings
9 Article L.632-1 of French commercial Code
10 In France, period (of 6 to 18 months) starting from the opening ruling during which an economic and social report on the Company is

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