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Blockchain Bites: FTX bankruptcy plan approved, UK Court rules that USDT is property, Crypto.com sues SEC seeking regulatory clarity, Eighteen firms and individuals charged in crypto market manipulation takedown

Steven Pettigrove, Jake Huang, Luke Higgins and Luke Misthos of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

FTX Bankruptcy Plan Approved

FTX has received court approval for its bankruptcy plan, which will allow the company to repay customers using $16.5 billion in assets recovered since its collapse in 2022. US Bankruptcy Judge John Dorsey approved the plan, calling FTX's restructuring "a model case" for handling a complex Chapter 11 bankruptcy.

The Repayment Plan

The wind-down plan, which was also approved by a majority of creditors, focuses on returning funds to FTX's customers before other competing claims, including those from government regulators. The first wave of repayments will see 98% of customers—those with USD$50,000 or less on the exchange—compensated within 60 days of the plan's effective date, which is still to be determined.

This move is significant for creditors, who were hit hard by the sudden downfall of FTX following revelations that founder Sam Bankman-Fried misappropriated customer funds to cover losses at his hedge fund, Alameda Research. Bankman-Fried is currently serving a 25-year sentence for his involvement (and appealing his conviction and sentence), but FTX's recovery efforts show that some justice may be on the way for its affected customers.

Payback in Percentages

FTX has indicated that customers will be paid 118% of the value in their accounts based on the account value in November 2022, when the company initially filed for bankruptcy. This is a standard approach in bankruptcy law, but some customers are expressing disappointment as Bitcoin has surged from USD$16,000 at the time of FTX's collapse to over USD$63,000 today, leaving creditors to argue they are missing out on massive gains in crypto prices.

Lawyer David Adler, representing a group of objecting creditors, stressed the frustration over the discrepancy, stating that it's difficult for customers to see this as full compensation. However, FTX has clarified that returning the actual crypto holdings is impossible because of the sheer number of assets, and that most of the assets were lost or misappropriated, making direct crypto refunds impossible. In the Mt Gox case in Japan, creditors were finally given Bitcoin as distributions, but the trustee in bankruptcy in that case only had to to deal with a single crypto-currency, and the shareholders of Mt Gox supported a distribution which gives 90% of the Bitcoin recovered to customers.

A Legal and Financial Victory

FTX negotiated with multiple parties, including US regulators like the Commodity Futures Trading Commission (CFTC) and Internal Revenue Service (IRS), as well as a Bahamian liquidator, to prioritise customer repayments over government

penalties. The cooperation of these agencies and the liquidation team was critical, allowing FTX to push customer repayments ahead of other liabilities like fines and taxes.

FTX's CEO John Ray acknowledged the hard work that went into reconstructing the company's financials and securing the assets needed for the repayments. Author Michael Lewis, however, has suggested that the hard work was more complicated than needed due to Mr Ray not working with senior executives early in the bankruptcy process. FTX has also raised additional funds through the sale of assets, including investments in tech companies like the AI startup Anthropic.

Looking Ahead

As the FTX bankruptcy gears up to distribute repayments, past customers are watching closely. While some customers may not be satisfied with their recovery amounts, the approval of the wind-down plan offers a significant resolution to one of the most high-profile crypto collapses in history, and given how few insolvencies and bankruptcies end in distributions of any meaningful amount, this outcome will be held up as a successful result for the insolvency industry.

The FTX case underscores the importance of stronger regulatory oversight and more transparent exchange operations. While the crypto market has rebounded significantly since FTX's collapse, the risks involved when proper governance is lacking have been laid bare by the aftermath of the insolvency.

While the FTX administration's success in managing this complex bankruptcy will provide lessons for handling future financial crises and has been aided strong asset recoveries, this remarkable result is also the consequence of a significant windfall from rising crypto-assets prices and a booming AI market.

Written by Steven Pettigrove, Luke Misthos and with Michael Bacina

What if crypto is property? UK Court rules on USDT

A recent decision by the English High Court has confirmed that the cryptocurrency USDT is capable of being property under English common law. This decision has significant implications for the treatment of cryptocurrency in the context of property tracing and legal remedies in the event that one's cryptocurrency is scammed or stolen.

Summary of facts and claims

In *D'Aloia v Persons Unknown Category A and others*, the claimant was allegedly induced into transferring cryptocurrency totalling around £2.5m, some in the form of Tether (USDT), to the first defendant via an online exchange operated by the sixth defendant, Bitkub.

Once the USDT had been received, it was transferred between various accounts on the exchange multiple times, before being passed through a digital wallet owned by Bitkub, in which the claimant's funds were mixed with those of many other users.

Finally, it was transferred to the seventh defendants, also persons unknown, and withdrawn as fiat currency.

Believing that he had been defrauded by the first and seventh defendants, whose identities remained unknown, the claimant brought claims against various cryptocurrency exchanges with which the seventh defendants had held accounts, including Bitkub.

Supporting claims of unjust enrichment and breach of constructive trust against the sixth defendant, the claimant submitted that he could trace and/or follow some of the USDT which had been transferred through the sixth defendant's wallet.

Two of the key issues that arose between the parties were:

1. whether USDT could be classed as property subject to tracing and following: and
2. whether common law tracing and following was permissible when the funds had been mixed.

What did the judge say?

First of all, Deputy Judge Farnhill of the High Court held that USDT was a class of assets which attracted property rights for the purpose of English law – i.e. the cryptocurrency was property. This type of property sits outside of the traditional categories of property, being either a chose in action, or a chose in possession. This view is consistent with that of the UK Law Commission and the draft legislation recently proposed to clarify the legal status of cryptoassets as capable of being

property under UK law.

Secondly, Farnhill DJ held that in theory, where the USDT had been held by Bitkub in a mixed fund, it was impermissible for the claimant to trace it at common law in support of his unjust enrichment claim. However, where each individual USDT maintained a distinct identity even when mixed, it could be characterised as a persistent thing. In the latter case, a claimant could in principle follow the currency through different wallets and mixtures. Unfortunately, the claimant had failed to demonstrate with sufficient evidence that any portion of his USDT had entered Bitkub's wallet. This was fatal to his unjust enrichment claim.

Implications of treating cryptocurrency as property

Arguably, no one area of law so fundamentally affects the legal nature of cryptocurrency as that of property law. The recognition of cryptocurrency as property is critical to the application of private law to transactions involving them (e.g. trust issues and judicial remedies as discussed above), with consequences not only for users of distributed ledger technology systems, but also third parties dealing with those users.

The issue also has implications across a number of other areas of law including criminal law (e.g obtaining property by deception) and taxation. Interestingly, its implications for AML laws may be limited by the fact that the definition of "property" under current legislation excludes at least some "digital currencies". In any event, resolving the "property question" in relation to cryptocurrency is thus of critical importance.

The D'Aloia case adds to an ever growing body of common law decisions across multiple jurisdictions recognising that cryptocurrency is a type of property. While we are yet to see a definitive legal ruling on this issue in Australia, the latest judgment is likely to be influential when the Australian Courts are asked to determine this issue.

Written by Jake Huang and Steven Pettigrove

Texas showdown: Crypto.com sues SEC seeking regulatory clarity

Crypto.com has taken a firm step to push back at the increasingly muscular approach of the US Securities and Exchange Commission (SEC) by suing the agency after Crypto.com received a Wells Notice. The lawsuit claims that the SEC is overstepping their statutory authority by attempting to regulate secondary sales of network tokens (like Solana and Filecoin) under traditional securities laws and is similar to the action brought by Coinbase against the SEC as well as a popular song creator. This issue has stirred controversy for some time as exchanges grapple with the fundamental issue that, if crypto assets are regulated under traditional securities laws in the US as Mr Gary Gensler, SEC Chair, has repeatedly asserted, there is no path to compliance or legal way to offer them despite Chair Gensler telling projects to "come in and register".

A Wells Notice indicates the SEC's intention to recommend enforcement action against a recipient, and are usually a harbinger of regulatory enforcement action. Crypto.com, however, isn't backing down, arguing that the SEC's approach to crypto is not only an overreach but also creates a de facto rule that essentially categorises almost all crypto assets as securities.

Crypto.com argues that this goes beyond the legal bounds of the SEC's jurisdiction, which is found in securities regulation—not digital commodities or goods. Calling the SEC a "misguided federal agency acting beyond its authorization under the law" on its website, Crypto.com has taken the fight directly to the SEC, seeking to put a stop to what they call the SEC's "illegal actions" which are "in excess of their authority and in violation of federal law". The company is seeking declaratory and injunctive relief against the SEC to limit it from taking enforcement action against the company.

This legal battle is part of a broader confrontation between the SEC and major crypto platforms. Industry heavyweights such as Coinbase, Robinhood's crypto arm, and OpenSea have all found themselves on the SEC's radar, receiving similar Wells notices, while other such as Coinbase and Consensys have taken their battle to the SEC by launching rule-making petitions or administrative actions. There are also suggestions of a shadow campaign against the US crypto industry via Operation Chokepoint 2.0 to pressure banks to discontinue servicing the industry.

In its lawsuit, filed in Tyler, Texas, Crypto.com has named SEC Chair Gary Gensler and four other commissioners as defendants, adding a personal dimension to the dispute. Alongside the lawsuit, the exchange has filed a petition with both the SEC and the Commodity Futures Trading Commission (CFTC), seeking clarity on the jurisdictional oversight and framework for crypto derivatives. Crypto.com asserts that certain products should be under the exclusive purview of the CFTC, not the SEC.

While the CFTC has yet to respond, this legal confrontation marks another significant moment in the ongoing struggle over the future of digital assets regulation. Crypto.com's case could set a precedent for how digital assets are regulated in the US, potentially reshaping the landscape for crypto businesses nationwide.

The outcome could also have ripple effects beyond the US, potentially influencing how cryptocurrency is regulated in Australia. Currently, Australia is working on its own regulatory framework for digital assets, with ASIC (Australian Securities and Investments Commission) and other government bodies keeping a close watch on international developments.

Written by Steven Pettigrove, Michael Bacina and Luke Misthos

Eighteen firms, individuals charged in crypto market manipulation takedown

The US Attorneys Office in the District of Massachusetts has unsealed criminal charges against 18 market makers, crypto projects and their founders/employees for alleged wire fraud, market manipulation and wash trading involving alleged market makers in the cryptocurrency markets.

The charges, brought in Boston, target the heads of four cryptocurrency companies, four market-making financial services firms, and various employees within those firms. This marks the first time that criminal charges have been filed against firms for these kinds of activities in the crypto space.

The Allegations

The defendants are accused of engaging in fraudulent schemes to artificially inflate the value of a number of cryptocurrency tokens through "wash trading"—a tactic where sham trades are executed to give the false appearance of trading volume, misleading buyers into believing a token has an available and liquid market. These companies then allegedly profited from the inflated token prices in classic "pump and dump" schemes, where the price of the token is artificially increased and the original holders sell their tokens at high prices.

The case involves several market makers and projects, including Saitama, which at its peak had an (allegedly inflated) multi-billion-dollar market cap. The market makers, including ZM Quant, CLS Global, and MyTrade, are accused of conspiring with cryptocurrency companies including NexFundAI, an FBI founded fake token, to manipulate token prices. One market maker is alleged to have admitted their goal was to deceive unsuspecting buyers: "we have to make [the other buyers] lose money in order to make profit."

Enforcement and Seizures

The ongoing investigation, dubbed "Operation Token Mirrors," has already led to four guilty pleas, the apprehension of several defendants across the US, UK, and Portugal, and the seizure of more than $25 million in cryptocurrency. Several automated trading bots responsible for millions of dollars' worth of wash trades, covering around 60 different cryptocurrencies, have also been shut down.

Federal authorities, including the FBI and the Securities & Exchange Commission (SEC), have drawn attention that innovative markets including cryptocurrency can still be subject to manipulation by old tactics like pump and dump schemes. There was a stark difference between the DOJ's announcement of the charges, and the SEC, with the latter asserting their new phrase to claim jurisdiction "crypto assets sold as securities" in their press release. The DOJ focused simply on the wrongdoing at the heart of the case.

A wake up call for buyers

In a statement, Acting US Attorney Joshua Levy warned that fraud in the cryptocurrency space will be aggressively prosecuted, emphasising the need for buyers to stay vigilant, saying:

> If you make false statements to trick investors, that's fraud. Period.

He further said:

> These charges are also a stark reminder of how vigilant online investors must be and that doing your homework before diving into the digital frontier is critical. People considering making investments in the

cryptocurrency industry should understand how these scams work so that they can protect themselves.

Jodi Cohen, Special Agent in Charge of the FBI's Boston Division, reinforced the message, explaining that this case represents "a new twist to old-school financial crime." The fact that the FBI created its own cryptocurrency token and company to engage with alleged wrongdoers is novel.

With recent enforcement action in Australia over a pump and dump scheme targeting ASX stocks, market manipulation organised through social media channels has become an increasing focus for regulators not just in the crypto-asset sphere. Australia is also a participant in the global Operation Spincaster, aimed at combatting scammers targeting crypto users.

This case underscores that crypto-assets markets are not immune from regulatory scrutiny and that market integrity is gaining international focus with a coordinated action by authorities in multiple jurisdictions aimed at protecting investors. As crypto-assets become more integrated into global finance, market participants should remember the potentially sweeping application of criminal and civil laws targeting fraud and market manipulation in financial services and crypto-asset markets.

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