



LOWENSTEIN BANKRUPTCY LOWDOWN

Lowenstein Bankruptcy Lowdown Video 15 – The Obligations and Responsibilities of Creditors’ Committees in Crypto Bankruptcies

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Phillip Khezri: Welcome to the third installment of the Lowenstein Lowdown video series on crypto bankruptcies. Today we are discussing the role of a creditors’ committee to investigate, preserve, and pursue causes of action in crypto bankruptcies.

Andrew Behlmann: In a Chapter 11 case, the Committee is empowered to oversee and investigate the past and current business of the debtor. The Committee may request documents, depose the debtor’s management and boards, subpoena records, and generally use any appropriate form of discovery to conduct its investigation.

It is imperative for the Committee to understand the true causes of the debtors Chapter 11 filing and how the Chapter 11 process can maximize recovery for unsecured creditors.

Phillip Khezri: Upon its appointment in a crypto case, the Committee will likely investigate the following issues:

- Management and other insiders’ actions prior to the bankruptcy filing, including undertaking excessive risk, misleading customers and other creditors about the debtor’s risk profile, insider trading of coins—especially prior to implementing a customer freeze—and market manipulation of crypto assets
- Excessive compensation of management and board members, including bonuses, pay increases, and other forms of compensation before—and sometimes after—the bankruptcy case
- Any investigations conducted by governmental agencies, including the SEC, against the debtor or its management and insiders
- Any significant business transaction which saddled the debtor with excessive debt, resulted in inadequate working capital, or exposed the debtor to significant risk
- Any new financing or amendments to financing which may have been above the market rate, imposed onerous covenants, or provided the lender with new collateral or a better priority of repayment—this investigation would include lending of the debtor’s crypto assets as well as loans using customer’s crypto assets

Andrew Behlmann: The committee must be vigilant to preserve causes of action for general unsecured creditors, as there are many instances where a debtor may seek to sell, assign, or release causes of action with little or no value accruing to general unsecured creditors.

Typically, the first instance in any bankruptcy case where causes of action may be lost is through debtor-in-possession financing. Nearly all debt financing motions provide that the debtor will grant liens on all unencumbered assets to the proposed DIP lender, including causes of action and the proceeds thereof. As such, one of the first critical duties of the Committee is to negotiate a revised proposal DIP lender to ensure that liens do not attach to causes of action or their proceeds.

Additionally, in a sale case, the Committee must ensure that causes of action are excluded from the assets being conveyed to the winning purchaser.

Finally, the Committee must be involved in the negotiation of any plan of reorganization or liquidation of a bankruptcy case to ensure causes of action are preserved for general unsecured creditors and not gratuitously released.

Phillip Khezri: Once causes of action are identified and preserved, the Committee must implement a mechanism to obtain standing and pursue recoveries on account of such causes of action.

In the Second Circuit, a committee may bring suit, even if the debtor does not unjustifiably refuse to do so, as long as (i) the debtor consents, and (ii) the court finds that the litigation is (a) in the best interest of the estate and, (b) necessary and beneficial to the fair and efficient resolution of the bankruptcy proceedings.

A Chapter 11 plan may also grant standing to a litigation trust to pursue a state cause of action post confirmation. Accordingly, in many bankruptcy cases, a committee should be focused on ensuring causes of action are preserved for the trust that the plan provides, for the trust to have standing to pursue those claims.

Andrew Behlmann: Stay tuned for future [Lowenstein Lowdown](#) videos in this Special Crypto Bankruptcy & Restructuring Series, as well as client alerts and articles on topics of interest to the crypto community. Thank you for watching.