Blockchain Law

Stop thinking great thoughts and just read the contract

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Perhaps the most valuable lesson I may ever have learned in law school was when an exasperated professor cut off a long-winded student by saying "Stop thinking great thoughts and just read the contract." A number of recent decisions in crypto bankruptcies and lawsuits illustrate a similar point — that the plain text of the contracts between platforms and users often matters far more to defining their rights than any of the policy debates or philosophizing that sometimes can occupy the FinTech community and press.

Escaping the clutches of bankruptcy

Bankruptcy Judge Martin Glenn's Jan. 4 decision in *In re Celsius Network, LLC*, 647 B.R. 631 (Bankr. S.D.N.Y. 2023), addressed a question that has attracted a great deal of concern in the recent spate of crypto bankruptcies: When a cryptocurrency platform goes into Chapter 11 proceedings, can account holders withdraw their account balances from the platform and transfer them elsewhere? Or must those balances stay with the platform as part of its bankruptcy estate—with the account holders relegated to the often unhappy status of general unsecured creditors of the estate who will recover only a modest fraction of their claims at such time as the bankruptcy is finally concluded?

Celsius was a crypto lending platform that offered various options to its users. One of those options was called the "Earn Program." It allowed customers to deposit crypto assets with Celsius and earn interest on them.

At the time of Celsius's Chapter 11 filing, it had approximately 600,000 Earn Program accounts with a total market value of approximately $4.2 billion, including stablecoins worth roughly $23 million.

Robert A. Schwinger is a partner in the commercial litigation group at Norton Rose Fulbright.

The debtors sought to sell approximately $18 million worth of stablecoins from the earn accounts, arguing that these stablecoins were Estate property that the debtors were permitted to sell under §363 of the Bankruptcy Code to fund operating expenses, including the costs of administering the Chapter 11 proceedings. The debtors argued that the plain language of the applicable terms of use governing the earn accounts unambiguously provided that the cryptocurrency assets in the Earn Program were the property of the debtors' estates.

While numerous parties objected on various grounds, the court concluded that "the terms of use formed a valid, enforceable contract between the debtors and account holders, and that the terms unambiguously transfer title and ownership of earn assets deposited into earn accounts from Accounts [sic] Holders to the debtors." Accordingly, the debtors' sale of the stablecoins from Earn Program accounts was approved.

The court first examined the way that Celsius users assented to the terms of use for earn accounts and found that it met the traditional criteria for entering into an enforceable online "clickwrap" agreement under New York law.

Users had to manifest assent by clicking a button confirming that they accepted the terms, or a button that implied that they had accepted the terms, although it did not necessarily require the user to view the terms.

Persons applying for accounts could not advance to the next page and complete the sign-up unless they agreed to the terms of use. The court noted that New York courts "overwhelmingly accept" such "clickwrap" agreements as being "sufficient to constitute mutual assent" for the formation of a contract.

The court also concluded that the terms of use agreement was supported by consideration, because it detailed how users could earn fees, proceeds or "rewards" from the assets they deposited into the earn accounts.

While the terms of use changed over time, and thus were signed onto in different forms by different users, the court noted that they all provided that the debtors could unilaterally modify the terms of use without notice and that the account holders' continued use of the platform following an update constituted consent to the amended terms of use.

In addition, in one of the later updates, the debtors specifically required all account holders to affirmatively accept the new version through pop-up windows and click-boxes, thus replacing whatever contract may have existed for any account holders who had opened their account before then.

The pop-ups provided links to the new terms, urged users to read them, and required affirmative acceptance of the new terms. Users who did not accept the new version within two weeks of its rollout had their accounts suspended until such time as they did.

The court next concluded that the terms of use were "unambiguous with respect to whether account holders retained ownership or transferred ownership of cryptocurrency assets by depositing the assets into earn accounts."

Although language varied in some of the earlier versions, by the time the affirmative acceptance of the new terms was required for all users, the terms of use explicitly stated that the account holders "grant Celsius … all right and title to such digital assets, including ownership rights."

The account holders thus "entered a contract which contained unambiguous and clear language regarding transfer of title and ownership of assets in earn accounts," and that "title to and ownership of all earn assets unequivocally transferred to the debtors and became property of the estates on the petition date."

'Loans' not inconsistent with transfer of ownership

Many of those who objected to the debtors' request to have the Earn Program's stablecoin holdings treated as estate assets that the debtors were free to sell argued "that Celsius's ubiquitous use of the word 'loan,' 'lending,' and other variations [in the terms of use] sits in direct conflict with the singular clause transferring all title and rights of ownership to the debtors," and that this therefore "creates an ambiguity within the four corners of the contract."

However, despite their argument that "a layperson's understanding of the term 'loan' means the account holder retains ownership of their earn assets but temporarily allows the use of the assets by the debtors," the court concluded that it "cannot ignore the plain and clear language in the transfer of title clause."

Even if account holders had "loaned digital assets to Celsius," they "would still be unsecured creditors." The court stated it was "blackletter law that a loan of money or property to another creates a debtor-creditor relationship" that is "contractual in nature," whereby "[t]he bank owns the deposit, the depositor has a claim to payment against the bank, and the bank has a corresponding obligation to pay its depositor," citing *In re Masterwear Corp.*, 229 B.R. 301, 310 (Bankr. S.D.N.Y. 1999).

In such a relationship, "absent a perfected security interest in tangible or intangible property, in the event of the debtor's bankruptcy, the creditor holds only an unsecured claim," citing *In re Motors Liquidation Co.*, 430 B.R. 65, 96 (S.D.N.Y. 2010).

The court specifically noted the difficulty under current law of perfecting security interests in cryptocurrency, because it is an "intangible" asset (citing Lorraine S. McGowen, *Transferring Digital Assets (Including Cryptocurrencies) Under Proposed Amendments to the Uniform Commercial Code*, The Quarterly Journal of INSOL International (4th Quarter 2022)).

The court thus concluded: "To read the terms of use such that 'loan' overrides the unequivocal language transferring title and ownership of assets deposited into earn accounts to Celsius's would be to read the transfer of title clause out of the contract entirely."

By contrast, "[t]he court can read 'lend' in harmony with the transfer of title clause, and the transfer of title and the creation of a loan are not mutually exclusive concepts."

To the extent the account holders argued that they were induced to enter the terms of use and make deposits into the Earn Program through allegedly improper statements by Celsius's former CEO, the court noted that this might constitute a securities law violation if true and might provide a defense to contract formation for a particular user. But it said that such issues were properly reserved for the claims resolution process and would not alter the determination of the contract's terms if a contract had been validly formed.

In addition to the foregoing points, some objecting parties had argued that "an actual transfer of ownership would have constituted a taxable event, yet the debtors paid no taxes on these transactions." The court's opinion did not expressly address this point, however.

In conclusion, the court stated that it "finds that earn assets in earn accounts constitute property of the estates, and that the debtors may sell stablecoins outside of the ordinary course of business." While "[t]he court does not take lightly the consequences of this decision on ordinary individuals, many of whom deposited significant savings into the Celsius platform," it would not allow those circumstances to alter the legal import and interpretation of the terms of use to which it found those individuals agreed.

A company's terms of use can vary by context

The bankruptcy court's conclusion bookended neatly with how it had handled an ownership issue the month before with respect to a different kind of Celsius user account, one that was governed by a different set of contractual terms. In an oral ruling on Wednesday, Dec. 7, 2022, the bankruptcy court authorized Celsius to return $50 million worth of crypto to users of Celsius's "Custody" accounts. See Greg Ahlstrand, "Crypto Lender Celsius' Bankruptcy Judge Orders It to Return $50M of Crypto to Custody account holders: Bloomberg" (Coindesk Dec. 7, 2022).

In its bankruptcy case filing seeking authorization to return those assets to those users, Celsius itself noted that the terms of use for the custody accounts expressly provided that "[t]itle to any [each customer's] Eligible Digital Assets in a Custody Wallet shall at all times remain with [the customer] and not transfer to Celsius" and that "Celsius will not transfer, sell, loan or otherwise rehypothecate Eligible Digital Assets held in a Custody Wallet."

A similar ruling was issued last year in another high-profile crypto bankruptcy, *In re Voyager Digital Holdings, Inc.*, 2022 WL 3146796 (Bankr. S.D.N.Y. Aug. 5, 2022). There the court concluded that “customers should be permitted to withdraw [cash] funds actually held for them in the two FBO [“for the benefit of”] accounts at [custodian bank] MC Bank” because “such funds are not property of the debtors’ bankruptcy estates.”

The court noted that “the customer agreement states that customers may deposit cash that will be held in an omnibus account at MC Bank,” and that “the bank provides all services associated with the movement of and holding of USD in connection with the provision of each account. Therefore, each customer is a customer of the bank.”

Another agreement stated that “[f]or clarity, at no time shall [Voyager] or any licensee ever collect, hold, or remit any customer program funds,” and that “the bank would be the ‘holder’ of the FBO accounts through which funds sent by customers would be held.”

The court accordingly concluded that “the debtors do not have either legal title or equitable interests to the funds in the FBO accounts” but only “administrative rights to direct cash movements.” As a result, “customers should be permitted to withdraw funds actually held for them in the two FBO accounts at MC Bank, [because] such funds are not property of the debtors’ bankruptcy estates.”

The importance of defining how transactions occur

Contractual language can also have a critical impact in determining what types of claims crypto platform users may be able to assert, as was shown in a recent case outside the bankruptcy context. *Underwood v. Coinbase Global, Inc.*, 2023 WL 1431965 (S.D.N.Y. Feb. 1, 2023), involved a putative nationwide class action brought by Coinbase customers who transacted in various digital tokens on the Coinbase platform from October 2019 to March 2022.

The plaintiffs alleged that 79 of these tokens qualified as “securities” under federal securities laws but that Coinbase was not registered with the U.S. Securities and Exchange Commission as an exchange or broker-dealer.

Plaintiffs asserted claims against Coinbase under §§5(a), 5(c) and 12(a)(1) of the Securities Act of 1933, 15 U.S.C. §§77e(a), 77e(c), 77l(a)(1), for damages allegedly arising from Coinbase’s alleged sale or solicitation of unregistered securities, and under §29(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78cc(b), for damages from allegedly illegal contracts that they claimed Coinbase had entered into with users to purchase and sell securities in violation of the Exchange Act’s registration requirements, as well as associated state-law and control-person claims.

Plaintiffs’ amended complaint alleged that the Coinbase platforms operate as “centralized exchanges” where trades “do not in fact happen on the blockchain and do not actually involve the transfer of any assets between users.” Rather, they claimed, “it is Coinbase that faces both the buyer and the seller,” and that when “two users wish to transact, each does so by transacting with Coinbase directly—not with each other.”

Coinbase moved to dismiss the claims in the amended complaint. While Coinbase disputed the assertion that the 79 tokens constituted “securities” under applicable law, the court determined that it did not need to resolve that contentious issue in view of other dispositive issues in the case.

The court began by noting that Sections 5(a) and (c) of the Securities Act prohibit any person from “selling” unregistered securities in interstate commerce unless exempt from registration. Section 12 in turn creates a private right of action “for the purchaser against the seller” in any transaction that violates Sections 5(a) or (c).

Citing the Supreme Court’s decision in *Pinter v. Dahl*, 486 U.S. 622 (1988), the court explained that in order to be a “statutory seller” who can face liability under Section 12, the defendant must either pass title to the buyer for value directly, without any intermediary parties, or must itself have solicited the purchase in order to serve its own financial interests or those of the securities owner.

The court conceded that plaintiffs’ amended complaint did in fact allege that Coinbase was a “seller,” because it alleged that Coinbase operated using a “centralized wallet” whereby Coinbase itself transacted with each of the buyer and the seller, with the parties being in privity not with each other but only individually with Coinbase.

However, the court noted that these allegations "effectively repudiate diametrically contrary allegations in plaintiffs' original complaint, in an apparent attempt to evade dismissal." Their original complaint had alleged that Coinbase users "enter into trade agreements with other Coinbase platform users for purchases and sales of digital assets," an allegation the court called "flatly opposite" the amended complaint's allegation that buyers and sellers were not in privity with each other.

Moreover, because the original complaint had made reference to the terms of the Coinbase user agreement, and sought relief based upon the contractual relationship that this agreement had created, the court held that it was entitled to go beyond the four corners of the operative pleading and consider the user agreement's terms on the motion to dismiss, even though the amended complaint had "stripp[ed] away all references to the user agreement."

The court's examination of the user agreement's terms showed that those terms supported the allegations as first made in plaintiff's original complaint and controverted the revised allegations in plaintiffs' amended complaint. The court stated:

> The user agreement's terms flatly contradict the [amended complaint's] allegations that Coinbase holds title to the digital assets. The user agreement — in language directed to the user—states that '[t]itle to digital currency shall at all times remain with you and shall not transfer to Coinbase.' It adds: 'You control the digital currencies held in your Digital Currency Wallet.' (Citations omitted.)

The user agreement in fact went even further, saying:

> "When you purchase (buy) or sell Digital Currency on the Coinbase Site, you are not buying digital currency from Coinbase or selling digital currency to Coinbase. Coinbase acts as the agent, transacting on your behalf, to facilitate that purchase or sale between you and other Coinbase [Inc.] customers."

The court concluded in these circumstances that it was not required to take as true for the purposes of the dismissal motion the amended complaint's allegations that Coinbase was the seller of the tokens. It thus held the plaintiffs had failed to meet the "statutory seller" requirement against Coinbase because they had not properly pled that Coinbase was their "immediate seller."

The court also held that Coinbase could not be deemed a seller under *Pinter v. Dahl*'s "solicitation" prong, because the amended complaint did not allege any "direct and active participation in the solicitation of the immediate sale" by Coinbase.

Rather, the court held that plaintiffs had alleged only "collateral" marketing and promotional activities by Coinbase, of the kind "held insufficient to establish active solicitation by a defendant" for §12 liability.

The court likewise held that plaintiffs' "illegal contract" claims under §29(b) of the Exchange Act failed. It said that plaintiffs had not alleged that "the contract involved a prohibited transaction," since Coinbase was not itself a party to any of the challenged transactions in which tokens were purchased or sold.

Rather, the "only contract" Coinbase had with the plaintiffs was the user agreement governing their use of the platform. But "performance of the user agreement did not necessitate illegal acts," since plaintiffs themselves conceded that the Coinbase platform could be used to trade tokens that did not qualify as securities.

Due to the failure of these substantive securities law claims based on the contractual terms, the court then dismissed the control-person and accompanying state-law claims and dismissed the action against Coinbase in its entirety with prejudice.

Defining who can be sued

A platform's contractual terms of use also proved dispositive in another recent ruling from the Celsius bankruptcy, where they likewise affected the determination of what claims could be asserted by the platform's customers and against whom. *In re Celsius Network, LLC*, 2023 WL 2421038 (Bankr. March 9, 2023), raised the question of whether Celsius customers "have claims against the debtors and all of their affiliates or only against Celsius Network, LLC ('LLC') under the terms of use?" In that case, however, finding the answer by looking to the terms of use proved not to be so easy because "[c]areless drafting of the terms of use leaves the answer unclear."

The court ultimately concluded that the terms of use were "ambiguous" on this question, because both sides' suggested interpretations of the document "have undesirable practical consequences." The court accordingly considered various "extrinsic evidence" and found, "based on a preponderance of the evidence, that the parties to the terms of use intended that only [Celsius Network,] LLC, and not any other debtor or non-debtor affiliates, are liable to customers *on contract claims* under the terms of use." (Emphasis in original.) But, "[i]mportantly, the court finds and concludes that the terms of use do not limit customers (or the committee) from asserting non-contract claims against [top-level parent Celsius Network Limited], or against other debtor or non-debtor affiliates, such as claims for fraud, negligent misrepresentation, or other statutory or common law claims."

Conclusion

The above rulings reinforce a fundamental principle that in the heat of the moment lawyers can sometimes overlook or think they can escape through creative pleading: When parties have chosen to define their relationship through a contract, that document's terms will typically prevail in court, even if extreme circumstances and potential undesirable consequences later arise that inspire creative attempts to recharacterize the relationship.

While the legal relationship between various kinds of crypto platforms and their customers is still a relatively new area for courts to explore, it is still at heart a commercial relationship.

In commercial law, contracts are the means by which parties typically seek to impose certainty upon their relationship that will endure despite whatever future contingencies may arise, whether contemplated by the parties or not.

While lawyers in this new space serve their clients well by bringing creative thinking to novel questions that the law may not have had an opportunity to consider previously, they should always bear in mind that the best advice in many situations might simply be to stop thinking great thoughts and just read the contract.