



Crypto Winter Series: What Are the Current Insolvency Concerns and What Do They Mean | Part 1 of 3

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News outlets and industry publications have been publishing information about recent “crypto winter” bankruptcies. In order to understand the impact of these bankruptcies as well as how they may impact your investments, it is important to understand what is currently known about these recent filings.

Skip ahead to [Part 2](#) and [Part 3](#) of our Crypto Winter series if you’re already up to speed on the 3AC and Voyager bankruptcies.

Three Arrows Capital Liquidation and Bankruptcy

The demise of Three Arrows Capital (3AC) is significantly tied to the company being heavily invested in the cryptocurrency Luna, which you will recall lost 99% of its value in May of 2022. 3AC’s losses due to Luna’s collapse, as well as the rapid decline in the value of other 3AC crypto investments, caused 3AC to default on its obligations to several lenders in late June. Certain lenders then exercised their rights to liquidate more than \$400 million of 3AC’s cryptocurrency positions.

The next development was Voyager Digital Holdings, Inc. (Voyager), which also had entered into cryptocurrency loans with 3AC. Voyager announced that it was owed nearly \$675 million and intended to default 3AC under their loans. On June 24, DRB Panama, Inc., as a creditor of 3AC, filed an application for the appointment of a liquidator in the British Virgin Islands (BVI). Days later, 3AC filed its own application for the appointment of a liquidator and publicly acknowledged it was insolvent and could not continue as a going concern. On June 29, the court in the BVI appointed joint liquidators for 3AC, thereby leaving the company’s directors and officers with little to no authority over the company’s continuing affairs.

The order appointing the joint liquidators empowered them to file a Chapter 15 bankruptcy petition in the United States. A Chapter 15

bankruptcy is a cross-border insolvency proceeding that allows foreign debtors such as 3AC to utilize the protections of the U.S. Bankruptcy Code to prevent creditors throughout the United States or abroad from using self-help remedies in contravention of the BVI's authority over the liquidation proceedings of 3AC. Both the BVI liquidation proceedings and the Chapter 15 bankruptcy of 3AC are in their infancy, and substantive movement has yet to occur. For now, the 3AC liquidators have taken steps to consolidate all 3AC corporate activities in the BVI, and intend to conduct an accounting, ultimately dissolve the debtor, and then marshal and distribute its assets to creditors through an orderly process.

Voyager Bankruptcy

Contrary to proceedings that 3AC is utilizing to liquidate assets and cease operations, Voyager has filed a Chapter 11 bankruptcy wherein it proposes to restructure its debt and affairs and continue as a going concern for the benefit of its customers and creditors. While 3AC is going out of business, Voyager intends to continue operations as a cryptocurrency brokerage platform.

Voyager filed its bankruptcy together with two related entities: Voyager Digital Ltd. and Voyager Digital, LLC. Voyager is wholly owned by Canadian company Voyager Digital, Ltd. The debtors have sought authority to have their cases jointly administered at bankruptcy case number 22-10943-MEW. The bankruptcy court will most likely approve this request. As of the date of filing, Voyager listed assets valued at \$5,087,725,000 and liabilities of \$4,901,129,000. Along with the usual first-day motions, Voyager has filed a proposed Plan of Reorganization (the "Plan").

Voyager has stated that it is a cryptocurrency brokerage and most of its customers utilize their app-based and online platforms to buy, sell, trade and store cryptocurrency, while also earning rewards for using the Voyager mobile app. Voyager's filings indicate that its operations consist primarily of (i) brokerage services where Voyager matches customers with counterparties to facilitate a cryptocurrency trade; (ii) custodial services for which customers earn interest and rewards on stored cryptocurrency assets; and (iii) lending programs with third parties.

When a customer makes a cryptocurrency deposit, it first enters Voyager's self-custody wallet system called Bedrock for verification, after which the customer's cryptocurrency is automatically swept from Bedrock to custodial accounts solely controlled by Voyager. To be clear, as soon as the customer's cryptocurrency hits Bedrock, the customer no longer has control over the cryptocurrency. Voyager does not maintain individual cryptocurrency wallets for each customer. Instead, cryptocurrency assets are commingled on an asset-by-asset basis within the third-party custodial accounts controlled by Voyager.

As of the Petition Date, Voyager had approximately \$1.1 billion in outstanding loans with 3AC and Alameda Research Ltd. To provide its customers with yield on their cryptocurrency assets stored with Voyager, Voyager loans out a portion of its crypto reserves to third parties. The Voyager customer agreement requires customers to acknowledge that Voyager may loan the deposited cryptocurrency assets in exchange for using the platform. In short, the Voyager customer agreement basically states that once a customer transfers cryptocurrency to the Voyager platform, the customer no longer retains ownership or control of their cryptocurrency, and Voyager may in fact commingle and use that cryptocurrency in any manner that it chooses. While the respective rights of Voyager and its customers may have been specified in their platform terms of use, many customers will argue that they did not understand these risks or were misled by Voyager.

Between March 2021 and March 2022, Voyager entered into 125 third-party loans with nine different counterparties lending out cryptocurrency with an aggregate value of \$5.15 billion. In March 2022, Voyager lent 3AC 15,250 Bitcoin and 350 million USDC, which was fully drawn down by 3AC. Following the Luna crash, it became apparent that 3AC would be unable to repay the loan, and ultimately Voyager issued a Notice of Default to 3AC due to 3AC's failure to make its loan payments. This default would become one of the primary triggers preceding the Voyager bankruptcy filing.

When a debtor files a petition for bankruptcy, it must select the nature of its business on the second page of the bankruptcy petition. Options range from industries such as health care to

railroads to stock brokering, but interestingly Voyager chose “none of the above.” From a bankruptcy perspective, this seemingly innocuous decision could have significant implications for Voyager’s customers and creditors. Although Voyager has described itself in its pleadings as a cryptocurrency brokerage, it is not classifying its customers as priority creditors in its proposed Plan but instead as unsecured creditors. The reason why this distinction may prove important is that in typical brokerage bankruptcies, customers are given priority status for claims related to their securities on deposit at the brokerage, and then general unsecured creditors of the defunct brokerage get only a pro rata portion of the liquidated value of the debtor’s assets. In the Voyager case, cryptocurrency customers are being classified as general unsecured creditors and that treatment could likely result in a recovery of far less than 100% of the value of the cryptocurrency they had transferred to the debtor’s brokerage platform. This threshold distinction plays a broader role in the challenges that the bankruptcy courts will be forced to address when examining the question of whether cryptocurrency should be classified as a currency or a commodity for purposes of the avoidance process and valuation methodology that a debtor or a trustee must utilize in the context of addressing claims against the debtor or held by the debtor against third parties.

Not surprisingly, in its bankruptcy filings, Voyager has reported that the extreme cryptocurrency market volatility, as well as a significant third-party exposure (3AC), had caused it to experience major liquidity concerns. Voyager has stated that throughout the month of June, it engaged in numerous liquidity and restructuring discussions with industry players and stakeholders and in fact successfully secured an unsecured loan from Alameda Ventures Ltd. Despite prepetition marketing efforts, Voyager was unable to secure a liquidity partner or sell itself and therefore commenced its bankruptcy proceedings to preserve the value of its business and to protect its customers’ and stakeholders’ interests. Voyager’s initial filings alleged that the distressed situations regarding Luna and 3AC exacerbated the industry’s “crypto winter.”

Takeaways

Voyager's proposed Plan provides for a standalone restructuring transaction that can be effectuated without a sale or a strategic partner. Under the Plan, account holders will receive on account of their unsecured claims a combination of (i) coins, (ii) new common shares in reorganized Voyager, (iii) existing VGX tokens, (iv) and any recovery on account of the 3AC loan. More specifically, the Plan treats account holders as impaired claimants who are entitled to vote for or against the Plan.

On July 8, the bankruptcy court heard the first-day motions of Voyager. These motions are filed to allow the debtor to continue operating its business in the ordinary course and generally address concepts such as payment of wages, maintenance of insurance, banking, and other organizational matters. The initial hearing on these motions may prove to be informative of some of the early concerns that the court may have as the Voyager bankruptcy plays out.

Frost Brown Todd will be closely monitoring these proceedings. Look for future articles on our [blockchain feed](#) providing more in-depth analysis on crypto bankruptcies, particularly if you may be exposed based upon 3AC or Voyager's filings.

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