

Enforcement of Claims against Crypto Assets

~ Practice in Japan ~

July 12, 2024

Issues of Crypto Assets in the Mt. Gox Case

Mt. Gox Case

● Outline of the Case

- ✓ Mt. Gox, which operated a crypto asset exchange, collapsed in February 2014 after a cyber attack that resulted in the outflow of Bitcoins, including those deposited by customers. On April 24, 2014, Mt. Gox, Inc. was ordered to commence bankruptcy proceedings in the Tokyo District Court.
- ✓ The following legal issues arose regarding crypto assets in the bankruptcy proceedings.
 - 1. Could ownership rights be established on crypto assets?**
 - 2. What claim does a customer have against a crypto asset exchange?**
 - 3. How do you decide the value of a customer's claim?**

1. Could ownership rights be established on crypto assets?

- Does a customer own crypto assets deposited with a crypto asset exchange?

In the Mt. Gox case, some of the customers claimed that:

- ✓ They have ownership rights to Bitcoin deposited with Mt. Gox,
- ✓ Their Bitcoin should not become part of the bankruptcy estate, and
- ✓ The trustee should return their Bitcoin deposits to them.

1. Could ownership rights be established on crypto assets?

- Court decision (Tokyo District Court, August 5, 2015 decision)

- ✓ Bitcoin does not have the **tangibility** and exclusivity necessary to be an “object” of ownership.
- ✓ Under the Japanese Civil Code, ownership rights exist only with respect to tangible things unless law expressly provided otherwise. Bitcoin is not physically tangible and therefore **cannot be owned**.



- ✓ Customers do not have in rem (property) rights in crypto assets deposited with crypto asset exchanges. Rather, they have in personam claims against crypto asset exchanges.

2. What claim does a customer have against a crypto asset exchange?

- Tokyo District Court decision on January 31, 2018

- ✓ The court ruled that the customers have the right to return of crypto assets against Mt. GOX.



- ✓ Such claims are not monetary claims, but claims that require currency-like treatment ("claim not for the payment of money" under the Bankruptcy Code)

3. How do you decide the value of a customer's claim?

- Reference date for valuation of right to return of crypto assets

- ✓ Under the Japanese Bankruptcy Code, the value of a claim not for the payment of money is estimated as of the time of commencement of bankruptcy proceedings.

- ⇒ The right to return of crypto assets is assessed based on the yen conversion rate of crypto assets at the time the bankruptcy proceedings commenced.

3. How do you decide the value of a customer's claim?

- In the Mt. Gox case

April 24, 2014 is the commencement date of the bankruptcy proceedings

1 Bitcoin = ¥55,800 (\$544)



During the bankruptcy proceedings, Bitcoin price soared

3. How do you decide the value of a customer's claim?

- The surge in Bitcoin prices would lead to the following consequences:
 - ✓ Even if all distributions were made, there may be **residual value** in the bankruptcy estate.
 - ✓ Creditors cannot be distributed gains on value appreciation.
 - ✓ Residual assets would be eventually paid to the owners of Mt. Gox, its shareholders.
- ⇒ Creditors filed a petition for **commencement of rehabilitation proceedings** on the grounds that such consequences are contrary to justice.

3. How do you decide the value of a customer's claim?

- Estimating the value of the claim in rehabilitation proceedings
 - ✓ Under the Japanese Civil Rehabilitation Act, the value of a claim is **estimated as of the commencement of rehabilitation proceedings**.
 - ✓ In the Mt. Gox case, the rehabilitation was commenced on June 22, 2018
 - 1 Bitcoin = ¥749,318 (\$6,811) : 15 times more value
 - ⇒ Creditors may receive at least the increase in value up to the time of commencement of rehabilitation proceedings.

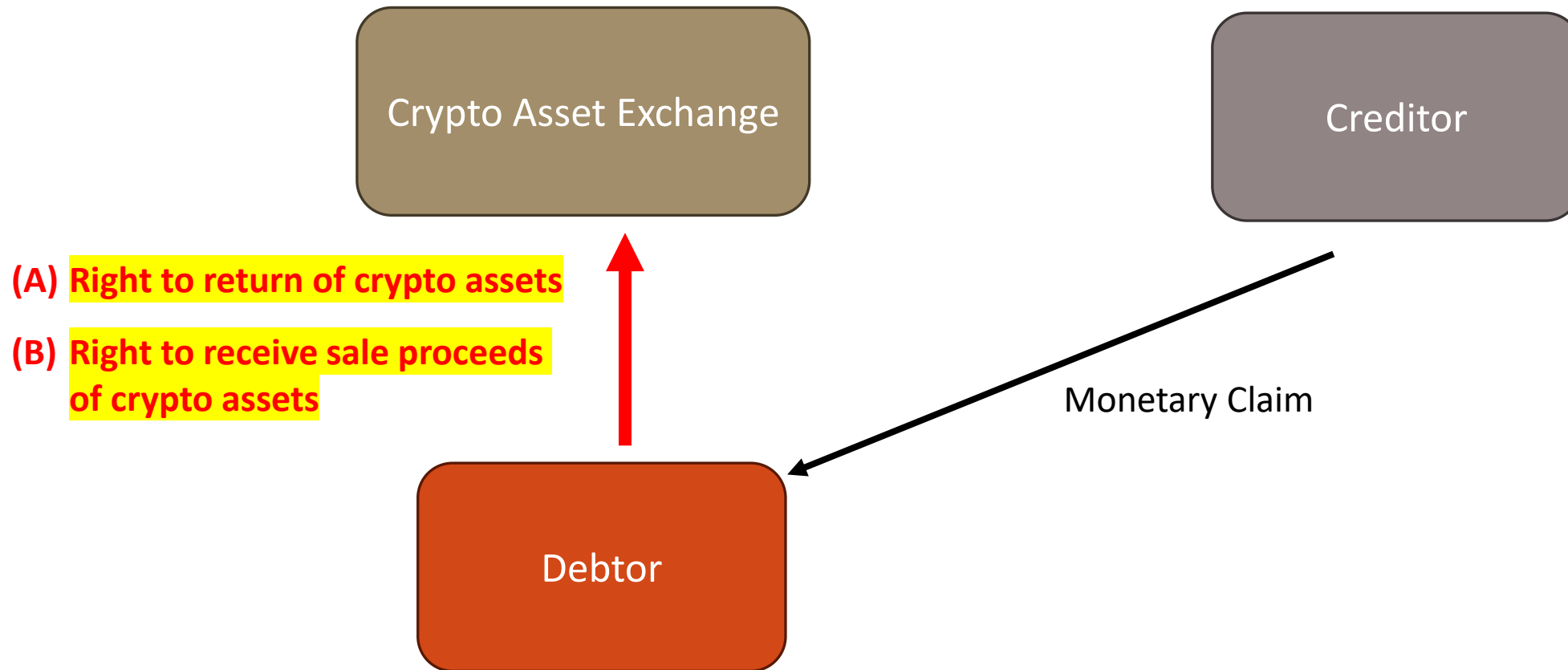
Enforcement Practices after the Mt. Gox Case

Enforcement Practices after the Mt. Gox Case

Enforcement on a debtor's crypto assets: there are two methods of holding crypto assets

1. Crypto assets deposited with a crypto asset exchange
⇒ Enforcement practices are established
2. Crypto assets held by participating network users through their wallets and their private keys
⇒ Difficult to enforce

1. Crypto Assets Deposited with a Crypto Asset Exchange



1. Crypto Assets Deposited with a Crypto Asset Exchange

(A) Right to return of crypto assets

An agreement exists between the crypto asset exchange and the user for the management of the crypto assets, and under the said agreement, the user has a right to return of the crypto assets deposited.

(B) Right to receive sale proceeds of crypto assets

Some terms and conditions of crypto asset exchanges include a provision that, in the event of seizure of the user's property, the contract of use will be terminated, the crypto assets in the account will be sold at a predetermined rate, and the proceeds (in yen) of the sale will be paid to the user.

1. Crypto Assets Deposited with a Crypto Asset Exchange

- Example: GMO Coin Service Basic Terms and Conditions

22.2 If a customer falls under any of the following items, the Company shall, without prior notice, demand, etc., and without any liability to the customer, suspend or limit the provision of all or part of the Service to the customer, or cancel the Service.

(1) Suspension of payment or insolvency of payment

(2) When a bill or check is dishonored

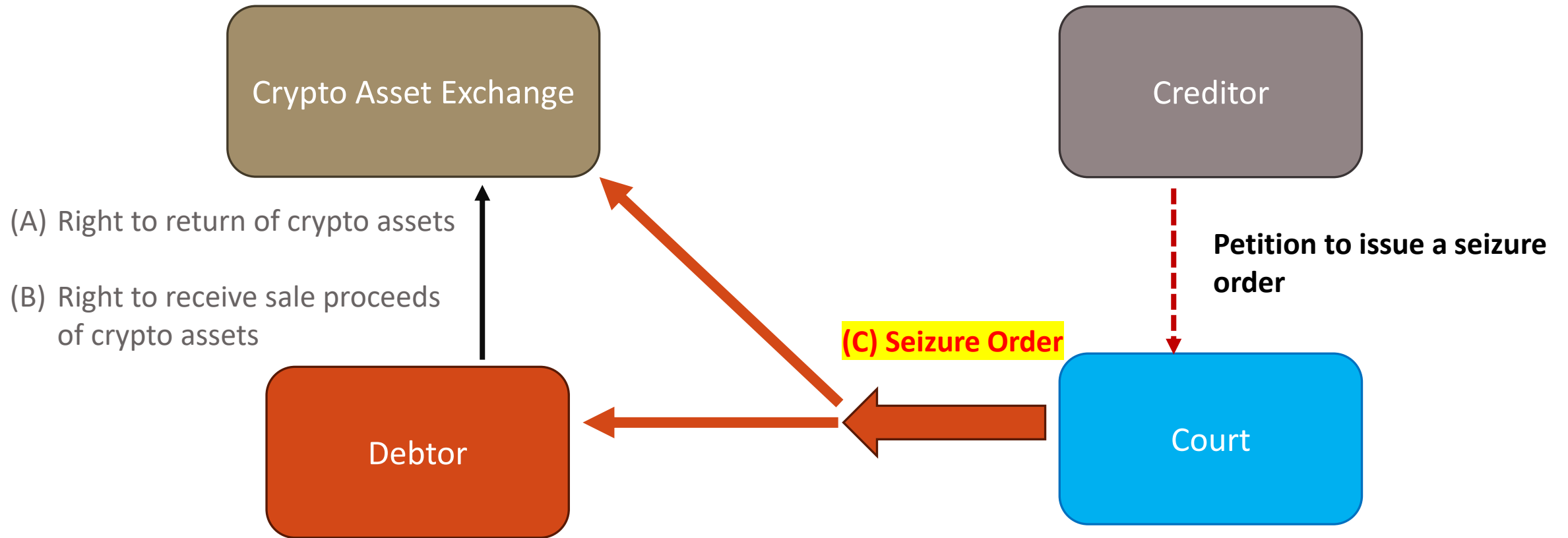
(3) If there is a petition for seizure, provisional seizure, or auction

1. Crypto Assets Deposited with a Crypto Asset Exchange

- Example: GMO Coin Service Basic Terms and Conditions

22.5 In the case specified in each item of Paragraph 2, if deemed necessary, the Company may dispose of assets held by the Company for the Customer in a manner the Company deems appropriate (including the conversion and disposal of cryptographic assets in accordance with market prices the Company deems appropriate).

1. Crypto Assets Deposited with a Crypto Asset Exchange



1. Crypto Assets Deposited with a Crypto Asset Exchange

(C) Seizure Order

1. The seizure order forecloses the debtor's rights against the crypto asset exchange.
2. The order prohibits the debtor from exercising or otherwise disposing of its rights against the crypto asset exchange.
3. The order prohibits the crypto asset exchange from following instructions of the debtor for the transfer of crypto assets and return of sales proceeds.
i.e., The crypto asset exchange must take measures **to freeze the debtor's account**.

Furthermore, the crypto asset exchange shall respond to the demand from the court and disclose the existence or non-existence of the crypto assets and the balance of the debtor's account.

1. Crypto Assets Deposited with a Crypto Asset Exchange

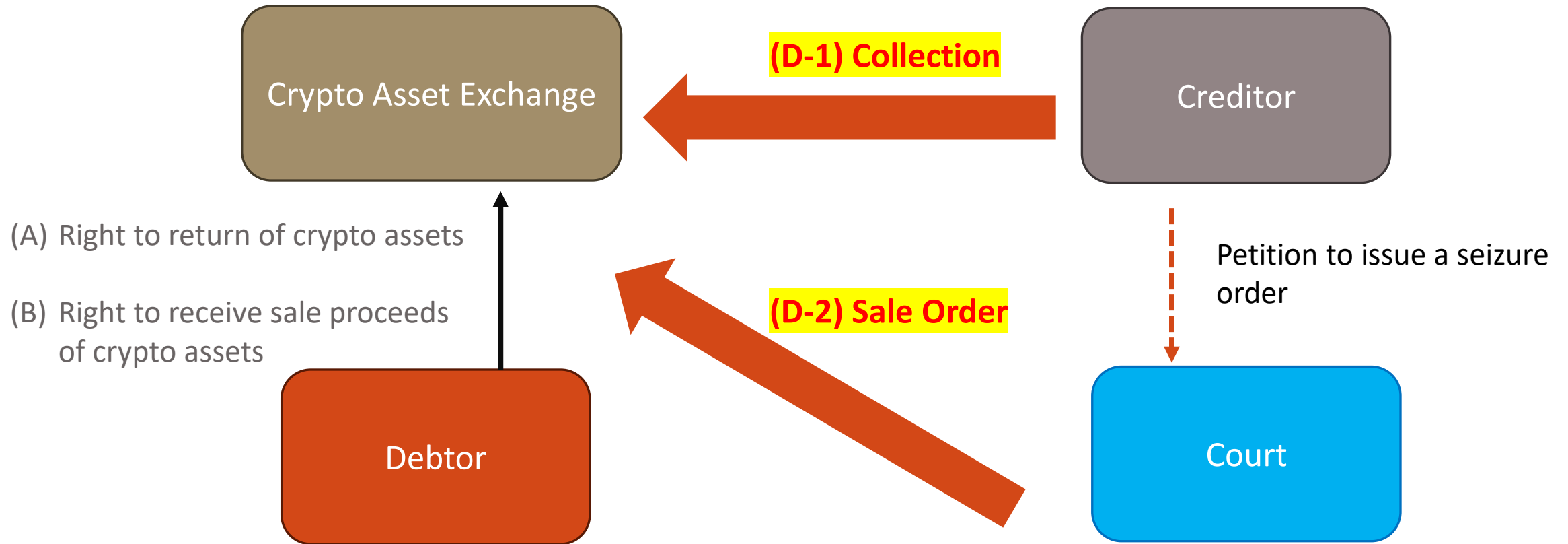
How is the price of crypto assets determined?

- ✓ The right to return of crypto assets shall be valued at the time the seizure order is served on the crypto asset exchange based on the trading price of the crypto asset in the market operated by the crypto asset exchange.



- ✓ Even if the price of the crypto assets fluctuates after the seizure order is served, the value of crypto assets subject to seizure will not change.

1. Crypto Assets Deposited with a Crypto Asset Exchange



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(D-1) Collection

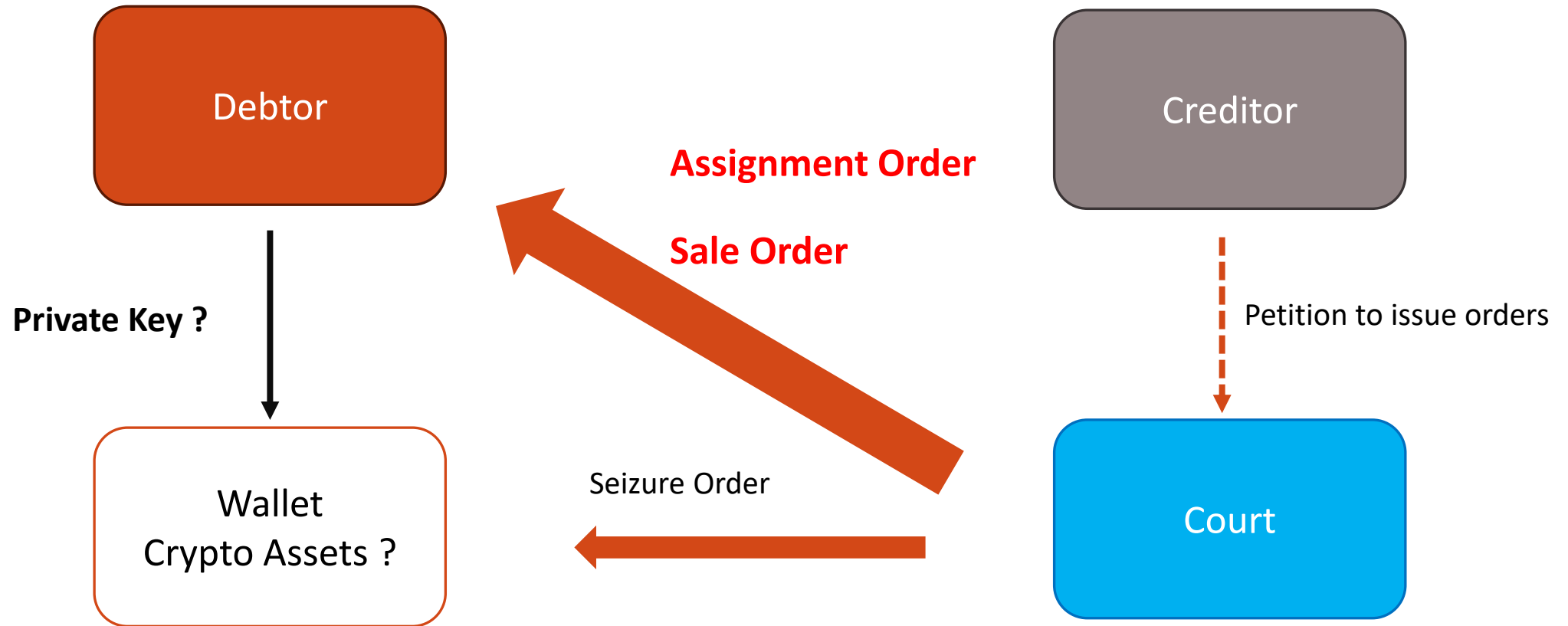
- ✓ Crypto assets cannot themselves be collected.
- ✓ When crypto assets are voluntarily sold by the crypto asset exchange in accordance with the terms and conditions of service, the creditor can exercise the right to receive sale proceeds against the crypto asset exchange.

1. Crypto Assets Deposited with a Crypto Asset Exchange

(D-2) Sale Order

- ✓ If the crypto asset exchange does not voluntarily sell the crypto assets, the court orders the crypto asset exchange to sell the crypto assets.
- ✓ The crypto asset exchange pays the proceeds of the sale to the court and the court distributes the proceeds to the creditor. The excess amount is refunded to the debtor.

2. Crypto Assets Held by Participating Network Users



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In practice, there is no effective enforcement method.

- ✓ Seizure Order
- ✓ Assignment Order:
 - an order to assign the property to the creditor for a court-ordered amount
- ✓ Sale Order:
 - an order to the execution officer to sell the property of the debtor



- ✓ However, **not effective unless the private key is disclosed** by the debtor
- ✓ Risk that the debtor may transfer the crypto assets before such execution

Measures to Require Disclosure of Private Keys

Use of **Property Disclosure Procedures** under the Civil Execution Act

- ✓ Procedure whereby the debtor is ordered to appear before the court and makes a statement of the status of the debtor's property.
- ✓ Failure to appear, failure to make a statement, or making a false statement shall be subject to a penalty (imprisonment for not more than six months or a fine of not more than JPY500,000).

Sanctions for Concealing Crypto Assets

Crime of destruction of property for the purpose of obstructing compulsory execution

- ✓ Concealing, damaging, or feigning the transfer of property that is or should be subject to compulsory execution, or feigning the incurrence of a debt.
- ✓ Subject to imprisonment for not more than three years or a fine of not more than JPY250,000.

Implications for Legal Reform

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- ✓ Practices for compulsory execution on crypto assets deposited with crypto asset exchanges are being established.
- ✓ On the other hand, compulsory execution for crypto assets held by participating network users through their wallets and private keys has not been carried out in practice since there are obstacles to enforcement.



- ✓ Measures to require disclosure of private keys and severe sanctions for concealing crypto assets before enforcement action may be necessary.

Thank you

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