WHAT CAN THE NORTH DAKOTA LEGISLATURE DO TO PROTECT CONSUMERS IN CRYPTOCURRENCY EXCHANGE CHAPTER 11 BANKRUPTCIES?

ABSTRACT

Cryptocurrency is a relatively new technology that poses significant legal challenges. Specifically, cryptocurrency causes substantial risk to consumers when a cryptocurrency company files for Chapter 11 bankruptcy. These risks are unprecedented, and the law fails to provide consumers with protection when a cryptocurrency company files for Chapter 11 bankruptcy. Many of the risks associated with cryptocurrency exchanges and Chapter 11 bankruptcy can be attributed to the lack of federal and state regulation. Additionally, multiple cryptocurrency companies, including Voyager Digital Holdings, FTX, and Celsius, have filed for Chapter 11 bankruptcy, which required judges to interpret various sections of Chapter 11 of the U.S. Bankruptcy Code in an unprecedented way. The federal government, its agencies, and state governments are only starting to attempt to provide a solution by regulating cryptocurrency. President Biden issued an executive statement, and the Government Accountability Office issued a report that directs financial agencies to consider regulating cryptocurrency, but the federal government has failed to take affirmative steps toward its regulation. Further, Congress has not successfully passed a bill to regulate cryptocurrency at the federal level.

North Dakota is a leader in Bitcoin mining by promoting cryptocurrency transactions and encouraging cryptocurrency businesses to do business within the state. North Dakota has also issued guidance to credit unions within the state and considered adopting a central bank currency. Similarily, Wyoming and New York have enacted laws regulating cryptocurrency. While neither state's law is perfect, each mitigate the harmful effects that cryptocurrency can have on consumers. Since cryptocurrency is still relatively new and lacks federal regulation, the North Dakota legislature should adopt statutes similar to Wyoming and New York, while keeping federal policy initiatives in mind. Ultimately, North Dakota must regulate cryptocurrency to protect consumers and provide bankruptcy courts with useful guidance.

I. INTRODUCTION

At this time, there is no federal agency designated to insure cryptocurrency exchanges.[1] Cryptocurrency exchanges are still new, so few rules currently exist to protect consumers who choose to place their assets in them.[2] Cryptocurrency exchanges provide a place for investors to store their cryptocurrency holdings in a cryptocurrency wallet; the exchange is the only entity

1. Brandon R. Wood, *Consumer Corner, Pendulum of Deregulation Swings at Consumer Crypto Creditors*, AM. INST. BANKR. J., Mar. 2023, at 16, 16.
2. *Id.*

able to access the cryptocurrency.[3] Additionally, the exchange can commingle investors' holdings with other investors' holdings in the same crypto wallet controlled by the exchange.[4] When a bank fails, the Federal Deposit Insurance Corporation ("FDIC") can take over the bank, liquidate its assets, and provide coverage to the insured account holders.[5] Cryptocurrency exchanges create a unique problem because they act like banks but are not federally regulated, so when a cryptocurrency exchange fails, its consumers find themselves in bankruptcy court.[6] This becomes an even larger issue because there is a lack of law on cryptocurency, so the courts must determine the rights of cryptocurrency consumers as a matter of first impression.[7] Cryptocurrency exchanges are more than marketplaces; they also function as brokerages by holding immense amounts of customer-deposited funds.[8] Because cryptocurrency exchanges hold massive amounts of customer funds, a failing cryptocurrency exchange can create problems for consumers and investors.[9]

II. LEGAL BACKGROUND

To understand how cryptocurrency can cause issues for courts, consumers, and investors when cryptocurrency exchanges file for Chapter 11 bankruptcy, one must gain a basic understanding of the working pieces. These working pieces include cryptocurrency, pertinent Chapter 11 bankruptcy code provisions, and court decisions in Chapter 11 bankruptcy cases involving cryptocurrency exchange.

A. CRYPTOCURRENCY EXPLAINED

Cryptocurrency is a broad identifier, but at its core, cryptocurrencies are defined as "digital or virtual currencies underpinned by cryptogenic systems."[10] Furthermore, cryptocurrencies provide consumers with a way to make "secure online payments without the use of third-party intermediaries."[11] "Most cryptocurrencies exist on decentralized networks using blockchain technology."[12] Blockchains are similar to spreadsheets or databases,

3. Adam J. Levitin, *Not Your Keys, Not Your Coins Unpriced Credit Risk in Cryptocurrency*, 101 TEX. L. REV. 877, 880 (2023).

4. *Id.*

5. Wood, *supra* note 1, at 16.

6. *Id.*

7. *Id.*

8. Levitin, *supra* note 3, at 879.

9. *Id.* at 880.

10. *Cryptocurrency Explained with Pros and Cons for Investment*, INVESTOPEDIA (May 26, 2024) https://www.investopedia.com/terms/c/cryptocurrency.asp [https://perma.cc/G2PG-RJY2].

11. *Id.*

12. *Id.*

but they provide different structures and data organization.[13] Blockchains consist of programs known as "scripts."[14] When the blockchain is distributed, several copies of script are saved on various devices, and each copy must match to be verified.[15] After distribution, the blockchain will collect transaction information which it enters into a "block."[16] Every block is comprised of a set of independently verified transactions that are authenticated by validators on a network; each new block is required to be authenticated before it can be confirmed.[17] This process makes "it almost impossible to forge the transaction histories."[18] Cryptocurrencies are unique because central banks typically do not issue them, thus they often avoid government oversight.[19]

There are many types of cryptocurrencies on the market, and the coin's name typically identifies the cryptocurrency.[20] Cryptocurrencies fall into various categories based on the coin's type.[21] Types of cryptocurrency coins include utility, transactional, governance, platform, and security tokens.[22] Understanding the types of cryptocurrencies and their purpose is essential for buyers' investment strategy.[23] If a coin has a purpose, the coin poses less risk for the investor than a coin without a purpose.[24] Further, the legality of cryptocurrency is dependent on the jurisdiction since public or private entities do not back it like they do for traditional currency.[25] Cryptocurrencies exist outside of established financial structures, giving governmental agencies pause.[26] Finally, cryptocurrencies hold a reputation for being unstable investments because of "high investor losses due to scams, hacks, bugs, and volatility."[27] Because cryptocurrencies hold the reputation of being unstable, one can start to understand how the complexities of cryptocurrencies can cause issues in the bankruptcy setting.

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13. Adam Hayes, *Blockchain Facts What It Is, How It Works, and How It Can Be Used*, INVESTOPEDIA (May 17, 2024) https://www.investopedia.com/terms/b/blockchain.asp [https://perma.cc/9R69-M7GS].
14. *Id.*
15. *Id.*
16. *Id.*
17. *Cryptocurrency Explained with Pros and Cons for Investment*, *supra* note 10.
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*

B. CHAPTER 11 BANKRUPTCY BASICS

To understand what happens to cryptocurrency investors and consumers when a cryptocurrency company files for Chapter 11 Bankruptcy, one must first gain a general understanding of Chapter 11 Bankruptcy.[28] Chapter 11 Bankruptcy is also known as reorganization, and it is available to businesses or individuals.[29] The goal of reorganization is to keep the "business alive and pay creditors over time."[30] To begin the Chapter 11 bankruptcy process, a debtor will either voluntarily file a petition with the court, or a creditor will submit an involuntary petition on the debtor's behalf.[31] Under 11 U.S.C. § 101(13), a debtor is defined as a "person or municipality concerning which a case under this title has been commenced."[32] A creditor is defined as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."[33] A plan of reorganization and disclosure statement will be required by the court in a Chapter 11 proceeding.[34] A disclosure statement lists the debtor's assets, liabilities, and business affairs allowing a creditor to determine the debtor's plan of reorganization.[35] A reorganization plan will include classification of each claim and provide a specific outline of how each class will be addressed in the plan.[36] Understanding the basics of Chapter 11 reorganization is an integral component in demistifying the complexities of cryptocurrencies.

C. WHY CRYPTOCURRENCY CAN BE DETRIMENTAL TO INVESTORS & CONSUMERS

Recovering cryptocurrency in a bankruptcy case can be tricky.[37] Debtors filing for bankruptcy are required to report all of their assets in their bankruptcy schedules, including cryptocurrency ownership interests.[38] Individual debtors may keep particular property dependent on state law or federal exemptions; however, "there are no federal or state exemptions for

28. *See generally Chapter 11 - Bankruptcy Basics*, U.S. CTS., https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/Chapter-11-bankruptcy-basics [https://perma.cc/58LA-25XN] (last visited May 27, 2024).

29. *Id.*

30. *Id.*

31. *Id.*

32. 11 U.S.C.A. § 101(13) (West 2022).

33. 11 U.S.C.A. § 101(10)(a) (West 2023) There are two other definitions of "creditor," however, they are not applicable here.

34. *Chapter 11 - Bankruptcy Basics*, *supra* note 28.

35. *Id.*; 11 U.S.C.A. § 1125 (West 2005).

36. *Chapter 11 - Bankruptcy Basics*, *supra* note 28; 11 U.S.C.A. § 1123 (West 2005).

37. *See* Jessica G. McKinlay, *Enforcing the Rights of Cryptocreditors*, 20 BERKELEY BUS. L.J. 83, 110 (2023).

38. *Id.*

cryptocurrency."[39] Cryptocurrency owners could potentially keep those assets if the cryptocurrency is located in an IRA account or exempt up to a certain dollar amount.[40] Ultimately, the United States Trustee's office is in charge of enforcing the policies and procedures in the Bankruptcy Code.[41]

During the bankruptcy process, trustees should ask distinct questions regarding a debtor's cryptocurrency assets.[42] Specifically, a Chapter 11 bankruptcy case requires the trustee to "ensure that the value of the cryptocurrency is accounted for in the schedules and subsequently in the bankruptcy plan."[43] Further, Section 1129 of the United States Bankruptcy Code requires that the reorganization plan meet the "best interests of the creditors test;" this means creditors may receive more than the amount received in a bankruptcy filing under Chapter 7 liquidation.[44] Section 1129 also requires that the reorganization plan follow the "absolute priority rule," that requires each class of creditor to "be paid in full before the shareholders retain any value."[45] In a Chapter 11 bankruptcy, "cryptocurrency should be considered an asset like cash, and the debtor should only be [allowed] to retain it if [it is] necessary for" the reorganization to be effective.[46] If the cryptocurrency is not necessary to make the reorganization effective, "unsecured creditors should receive the benefit of the cryptocurrency."[47]

It is also important to note that blockchain systems only address "the credit risk involved in transacting in cryptocurrencies"—not "the credit risk involved in holding cryptocurrencies."[48] In addition, the customer never really owns the cryptocurrency when they invest through the cryptocurrency exchange, so customers are similar to unsecured creditors and may be last in line for repayment during a bankruptcy proceeding.[49] Cryptocurrency user agreements vary significantly in terms of the risks disclosed to customers.[50] Additionally, 11 U.S.C. § 541(a)(1) creates a "bankruptcy estate," which includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[51] Since the extent of the debtor's interest becomes

39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.* at 112.
44. *Id.*; 11 U.S.C. § 1129 (2023).
45. *Id.*; 11 U.S.C. § 1129 (2023).
46. McKinlay, *supra* note 37, at 112.
47. *Id.* at 113.
48. Levitin, *supra* note 3, at 882 (emphasis in original).
49. *Id.* at 896.
50. *Id.*
51. *Id.* at 902; 11 U.S.C. 541(a)(1) (2023).

the extent of the bankruptcy estate's interest, the debtor could theoretically "sell its cryptocurrency holdings to provide cash for funding its bankruptcy expenses . . . , and [t]hose assets would not then be available for distribution to customers-creditors."[52] The cryptocurrency "exchange will always have at least a possessory interest in cryptocurrency held for customers . . . ."[53] Customers will most likely never "have automatic access to their cryptocurrency in the event of bankruptcy," and the court can only enforce a stay to a certain extent.[54] Foreign cryptocurrency exchanges cause more significant issues because the reach of a Chapter 11 bankruptcy can only do so much for the customer, and those customers may be unable to access their cryptocurrency in this situation.[55]

III. CRYPTOCURRENCY REGULATION ANALYSIS

Cryptocurrency is still relatively new, and regulatory responses vary depending on the country and state.[56] Bitcoin has become the national currency in some countries, and others have banned cryptocurrencies entirely.[57] The United States has not adopted a comprehensive approach to regulating cryptocurrencies.[58]

A. MAJOR CHAPTER 11 BANKRUPTCY CASES INVOLVING CRYPTOCURRENCY

In the past year, three major cryptocurrency exchanges filed for Chapter 11 bankruptcy in New York.[59] These companies include Celsius Network LLC ("Celsius"), Voyager Digital Holdings, Inc. ("Voyager"), and FTX Trading Ltd. ("FTX").[60]

Voyager filed for Chapter 11 bankruptcy in July 2022.[61] Voyager runs a cryptocurrency trading platform with depository and lending services.[62] Voyager's reason for filing a Chapter 11 bankruptcy was "to effectuate an orderly

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52. Levitin, *supra* note 3, at 902.
53. *Id.* at 903 (emphasis added).
54. *Id.*
55. *Id.*
56. *See* McKinlay, *supra* note 37, at 86.
57. *Id.*
58. *Id.* at 86-87.
59. *See In re* Celsius Network LLC, 647 B.R. 631 (Bankr. S.D.N.Y. 2023); *In re* Genesis Glob. Holdco, LLC, 652 B.R. 618 (Bankr. S.D.N.Y. 2023); *In re* Voyager Digit. Holdings, 649 B.R. 111 (Bankr. S.D.N.Y. 2023); *See also* Jason B. Binford, *The Role of Federal and State Regulators in Crypto Bankruptcies*, AM. BANKR. INST. J., May 2023, at 28.
60. *See* Binford, *supra* note 59, at 29, 48.
61. *Id.*
62. *Id.* at 29.

restructuring and stop a short-term 'run on the bank.'"[63] Voyager requested the court allow it to sell its assets or complete a reorganization process.[64] Initially, Voyager was going to sell its assets to FTX, but FTX also filed for Chapter 11 bankruptcy, so Voyager quickly sought court approval for an asset sale to Binance.US.[65]

Various federal agencies, including the United States Trustee and the Securities Exchange Commission ("SEC"), took an active role in this case because they had concerns with the proposed sale to Binance.US.[66] Federal regulators argued there was insufficient information on the asset sale and an unlawful sale structure as neither Binance.US nor the debtors were authorized to complete the sale in the relevant jurisdictions.[67] The SEC also argued Voyager could not issue new cryptocurrency under federal securities law.[68] However, the judge disagreed with these arguments and entered an order confirming Voyager's reorganization plan.[69]

Another cryptocurrency exchange, Celsius, filed for Chapter 11 bankruptcy in July 2022.[70] Celsius provided cryptocurrency customers with financial services that facilitated a platform to transfer cryptocurrency assets to secure loans.[71] Celsius filed for Chapter 11 bankruptcy due to "the company's inability to deploy assets on a profitable basis."[72] Many of the company's investors were drawn to to the cryptocurrency exchange's anonymity, however this created privacy concerns when Celsius filed for Chapter 11 bankruptcy.[73] In August 2022, Celsius filed a motion seeking to redact certain identifiable customer information, and then filed another motion to redact the customer names so the accounts could not be matched to a customer.[74] Like In re Voyager, federal agencies took proactive steps in this case.[75] Specifically, the United States Trustee argued that if the court granted Celsius's motion to redact customer information, the court would be going against the general rule in bankruptcy proceedings requiring the proceedings to be "open, public, and transparent."[76] The court agreed with the United States

63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.* at 29, 48.
68. *Id.* at 48.
69. *Id.*; *In re* Voyager Digit. Holdings, 649 B.R. 111, 143 (Bankr. S.D.N.Y. 2023).
70. Binford, *supra* note 59, at 48.
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.*

Trustee and did not grant Celsius's motion to redact customer names, instead entering an order approving bidding procedures for the sale of Celsius's assets.[77]

FTX filed for Chapter 11 bankruptcy in November 2022.[78] The incoming CEO stated the company exhibited unprecedented concerns because inexperienced people ran the corporation so poorly and lacked trustworthy financial information.[79] The case became more complicated when the company's founder faced multiple federal charges regarding misplacement of $8.9 billion in customer funds.[80] The United States Trustee argued that an examiner should be appointed to investigate the company, but the court ultimately decided this was unnecessary because the company's ongoing investigation complied with the Bankruptcy Code.[81] The court allowed FTX to sell certain assets to continue the restructuring process.[82]

B. THE FEDERAL GOVERNMENT'S APPROACH TO REGULATING CRYPTOCURRENCY

In March 2022, President Biden issued an executive order to encourage federal development of a comprehensive framework to regulate digital assets.[83] In prioritizing this regulation, President Biden stated that "[i]n November 2021, non-state issued digital assets reached a combined market capitalization of $3 trillion, up from approximately $14 billion in early November 2016."[84] President Biden further emphasized that the United States is considered a global leader in the "growing development and adoption of digital assets and related innovations," and the nation must "take strong steps to reduce the risks that digital assets could pose to consumers, investors, and business protections."[85] To this end, President Biden outlined policy objectives in Section 2 of the executive order, which included:

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77. *Id.* at 49.

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. Exec. Order No. 14,067, 87 Fed. Reg. 14143 (Mar. 9, 2022); *see also FACT SHEET White House Releases First-Ever Comprehensive Framework for Responsible Development of Digital Assets*, THE WHITE HOUSE (Sept. 16, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/09/16/fact-sheet-white-house-releases-first-ever-comprehensive-framework-for-responsible-development-of-digital-assets/ [https://perma.cc/G7XE-HKN2].

84. Exec. Order No. 14,067, *supra* note 83.

85. *Id.* President Biden also outlines that the country must take strong steps for "financial stability and financial system integrity; combating and preventing crime and illicit finance; national security; the ability to exercise human rights; financial inclusion and equity; and climate change and pollution."

> protect consumers, investors, and businesses in the United States[;] . . . protect the United States and global financial stability and mitigate systemic risk[;] . . . mitigate the illicit finance and national security risks posed by the misuse of digital assets[;] . . . reinforce United States leadership in the global financial system and in technological and economic competitiveness, including through the responsible development of payment innovations and digital assets[;] . . . promote access to safe and affordable financial services. Many Americans are underbanked and the costs of cross-border money transfers and payments are high[; and] . . . support technological advances that promote responsible development and use of digital assets.[86]

To implement this executive order, President Biden ordered multiple federal agencies to conduct research for the administration with reports to further the policy initiatives outlined in the executive order.[87]

The introduction of the Digital Commodities Consumer Protection Act of 2022 by the United States House and Senate is another federal attempt to regulate cryptocurrency.[88] Currently, each bill is under congressional review in the House and Senate.[89] The bills aim to grant "exclusive jurisdiction to the Commodity Futures Trading Commission over activity involving digital commodities."[90] "The bill defines digital commodities as fungible digital forms of personal property that can be transferred person-to-person without an intermediary."[91] Securities, interests in physical commodities, and government-backed digital currencies are excluded from the definition.[92] Under this bill, the commission does not have "jurisdiction over digital commodities used solely for the purchase or sale of a good or service."[93] Furthermore, the

86. *Id.*

87. *Id.*

88. H.R. 8730, 117th Cong. (2022); H.R. 8950, 117th Cong. (2022); S. 4760, 117th Cong. (2022). H.R. 8730 and S. 4760 are labeled as identical on Congress's website, and H.R. 8950 is labeled as related. However, all the bills have the same purpose despite assignment to different committees.

89. *H.R. 8730 – Digital Commodities Consumer Protection Act of 2022*, CONGRESS.GOV (Aug. 18, 2022), https://www.congress.gov/bill/117th-congress/house-bill/8730/actions; *H.R. 8950 – Digital Commodities Consumer Protection Act of 2022*, CONGRESS.GOV (Sept. 22, 2022), https://www.congress.gov/bill/117th-congress/house-bill/8950/actions; *S.4760 – Digital Commodities Consumer Protection Act of 2022*, CONGRESS.GOV (Aug. 3, 2022), https://www.congress.gov/bill/117th-congress/senate-bill/4760/actions.

90. *Summary H.R. 8730 – 117th Congress (2021-2022)*, CONGRESS.GOV (Aug. 18, 2022) https://www.congress.gov/bill/117th-congress/house-bill/8730/actions. This aim is reflected across H.R. 8950 and S. 4760.

91. *Id.*

92. *Id.*

93. *Id.*

bills would require "[d]igital commodity platforms (including brokers, custodians, dealers, and trading facilities) [to] register with the commission and comply with risk management and good governance procedures."[94] Each bill provides "recordkeeping requirements, conflict of interest standards, and other consumer protections."[95] Currently, Congress has yet to pass either bill.[96]

In addition to the Executive Order and bills in the House and Senate, the United States Government Accountability Office ("GAO") released a report to the public on July 24, 2023, recommending Congress consider legislation to address the harmful risks cryptocurrency poses to consumers and investors.[97] The "GAO found gaps in regulatory authority over two blockchain-related products that raise consumer and investor protection and financial stability concerns."[98] The first gap in regulatory authority the GAO found was that federal financial regulators do not have the authority to regulate cryptocurrencies that are not considered securities.[99] The second concern found was a lack of oversight in the regulation of stablecoins.[100] The GAO suggested Congress provide oversight to both of these regulatory gaps, to protect consumers, investors, and the financial system.[101] In addition to the recommendation that Congress provide legislation for federal oversight of cryptocurrencies and stablecoins, the GAO report provided specialized recommendations for seven financial regulators "to establish a (or adapt an existing) coordination mechanism to identify and address blockchain-related risks."[102] The GAO recommended Congress create legislation that

94. *Id.*

95. *Id.*

96. *All Actions H.R. 8730 – 117th Congress (2021-2022)*, CONGRESS.GOV (Aug. 18, 2022), https://www.congress.gov/bill/117th-congress/house-bill/8730/actions; *All Actions H.R. 8950 – 117th Congress (2021-2022)*, CONGRESS.GOV (Sept. 22, 2022), https://www.congress.gov/bill/117th-congress/house-bill/8950/actions; *All Actions S.4760 – 117th Congress (2021-2022)*, CONGRESS.GOV (Aug. 3, 2022), https://www.congress.gov/bill/117th-congress/senate-bill/4760/actions.

97. U.S. GOV'T ACCOUNTABILITY OFF., GAO-23-105346, BLOCKCHAIN IN FINANCE: LEGISLATIVE AND REGULATORY ACTIONS ARE NEEDED TO ENSURE COMPREHENSIVE OVERSIGHT OF CRYPTO ASSETS (2023).

98. *Id.*

99. *Id.*

100. *Id.*; Kara Bruce et al., *The Private Law of Stablecoins*, 54 ARIZ. STATE L.J. 1073, 1078 (2022). Stablecoins are similar to other cryptocurrencies like Bitcoin because they work on the same sort of blockchain networks.

101. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 97; *see* Bruce et al., *supra* note 100, at 1078-83 The mechanisms in place for holding this value greatly vary. This creates more risks for coinholders as they may risk losing their investment if the stablecoin issuer files for bankruptcy.

102. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 97; *See Spot Market Definition, How They Work, and Example,* INVESTOPEDIA (May 30, 2024) https://www.investopedia.com/terms/s/spotmarket.asp [https://perma.cc/GK7G-B296]. Spot markets enable financial instruments like currency to be traded for cash.

"designates a federal regulator to provide . . . comprehensive regulatory oversight of spot markets for nonsecurity [sic] crypto assets" and legislation that would provide for "consistent and comprehensive oversight of stablecoin arrangements."[103] Additionally, the GAO recommended that the seven financial regulators promptly organize to identify the risks of cryptocurrency products.[104] So far, neither Congress nor the seven financial regulators have done anything to take action recommended by the GAO.[105]

C. STATE GOVERNMENTS' APPROACH TO REGULATING CRYPTOCURRENCY

In 2019, Wyoming became the first state to adopt cryptocurrency legislation.[106] The Wyoming statute defines virtual currency as money, but the language allows "secured creditors to enter into agreements with cryptocurrency owners with cryptocurrency treated as intangible personal property."[107] Furthermore, the statute was Wyoming's first attempt to classify cryptocurrency.[108] The statute creates three categories of assets "[d]igital consumer asset . . . , [d]igital security . . . , [and] [v]irtual currency."[109] Each category is mutually exclusive.[110]

In addition to defining cryptocurrencies, Wyoming provides a successful regulatory answer to the custodial holding risks inherent to cryptocurrency exchanges.[111] "In 2019, Wyoming created a new type of banking charter for 'Special Purpose Depository Institutions' (SPDIs) in order to attract crypto businesses to the state."[112] SPDIs hold a special "type of limited banking charter that allows them to act primarily as custodians in cryptocurrencies."[113] SPDIs require deposit values in excess of $5,000 and are "generally prohibited from making loans using customer deposits of fiat currency."[114]

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103. *Blockchain in Finance Legislative and Regulatory Actions Are Needed to Ensure Comprehensive Oversight of Crypto Assets*, U.S. GOV'T ACCOUNTABILITY OFF. (Jun. 22, 2023), https://www.gao.gov/products/gao-23-105346 [https://perma.cc/5GQG-QQCU].

104. *See id.*

105. *Id.* The seven financial regulators include the United States Securities and Exchange Commission, Office of the Comptroller of the Currency, National Credit Union Administration, Federal Reserve System, Federal Deposit Insurance Corporation, Commodity Futures Trading Commission, and Consumer Financial Protection Bureau.

106. McKinlay, *supra* note 37, at 101; *see* WYO. STAT. ANN. §§ 34-29-101-107 (West 2023).

107. McKinlay, *supra* note 37, at 101; *see* WYO. STAT. ANN. § 34-29-101(a)(iii) (West 2023).

108. McKinlay, *supra* note 37, at 104; *see* WYO. STAT. ANN. § 34-29-101 (West 2023).

109. WYO. STAT. ANN. § 34-29-101(a)(ii)-(iv) (West 2023).

110. McKinlay, *supra* note 37, at 104; WYO. STAT. ANN. § 34-29-101(b) (2023) ("The terms in paragraphs (a)(ii) through (iv) of this section are mutually exclusive.").

111. Levitin, *supra* note 3, at 948.

112. *Id.*

113. *Id.*

114. *Id.*

Additionally, SPDIs are not allowed to use customer assets without customer instructions, and they must maintain "unencumbered, high-quality assets worth 100% or more of their 'depository liabilities.'"[115] Wyoming law does not define "depository liabilities," but it appears to only cover cash amounts of customer funds held in an SPDI. Depository liabilities prevent the liability coverage requirements from fluctuating based on the unstable cryptocurrency market prices by basing the liabilities on a fixed dollar amount of the deposit.[116] If an SPDI were to file for bankruptcy under Wyoming law, then customers' assets are protected because "Wyoming law provides that custodially held digital assets are neither liabilities nor assets of a bank."[117] Further, the federal Bankruptcy Code offers increased protections for cryptocurrency investors in Wyoming.[118] Despite this regulatory scheme, Wyoming has issued few SPDI charters, with the majority of cryptocurrency exchanges not holding Wyoming SPDI charters.[119] This could indicate that customers need to assess the risks if an exchange files for bankruptcy, or the cryptocurrency exchange may prefer instead the limited purpose trust charter or the New York Bitlicense.[120]

New York is another state that has taken action to regulate cryptocurrency.[121] New York offers a limited purpose trust company charter and Bitlicense for companies in cryptocurrency businesses.[122] The limited purpose trust charter offers a "general form of organization for companies that engage primarily in custodial operations of all sorts."[123] New York does not offer a specific statute for limited purpose trust companies, but "the term 'limited purpose' indicates that the trust company lacks the power to take deposits or make loans."[124] The limited trust purpose company holds customers' property in a trust, so cryptocurrency exchanges can structure themselves as a limited purpose trust company if they wish.[125] The advantages of a cryptocurrency exchange structure include a substantial reduction in credit risk in the event the company fails.[126] This is advantageous because the assets are

115. *Id.*
116. *Id.*
117. *Id.* at 949.
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.* at 945; *see* N.Y. COMP. CODES R. & REGS. tit. 23, § 200.1 (2023).
122. Levitin, *supra* note 3, at 945.
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*

held in an express trust, and the company is less likely to fail because it cannot make loans.[127]

The other solution for cryptocurrency regulation that New York provides is a Bitlicense. Bitlicense is available to "companies that store, receive for transmission, broker, exchange, or control or administer virtual currencies involving New York or a New York resident."[128] More companies may acquire a Bitlicense than a limited purpose trust.[129] A Bitlicense is granted at the discretion of the New York Superintendent of Financial Services.[130] Conditions to obtain a Bitlicense include individualized capital requirements and maintenance of a "surety bond or trust account for the benefit of its consumers in an amount" determined by the New York Superintendent of Financial Services.[131] Further, the company must provide the actual holding of virtual currency of the same type and amount that it has agreed to hold for customers, and the New York Superintendent of Financial Services "prohibits the licensee from using custodial assets other than at the customer's direction."[132] The Bitlicensee must follow these regulatory requirements, but there is no guarantee that the licensee will remain solvent and follow the license terms.[133] Bitlicenses and banking licenses are not the same thing, so cryptocurrency exchanges must follow Chapter 11 bankruptcy procedures in the event of insolvency.[134] Bitlicenses help licensees remain solvent and avoid Chapter 11 bankruptcy.[135] However, if the licensee files for Chapter 11 bankruptcy, customers of the exchange will be treated like unsecured creditors that will be last to recoup their assets.[136]

In response to multiple cryptocurrency exchange bankruptcies being filed in New York, the state's "Department of Financial Services issued 'Guidance on Custodial Structures for Customer Protection in the Event of Insolvency' for virtual currency entities—Bitlicensees and limited purpose trust companies alike."[137] The guidance provides that cryptocurrency

127. *Id.*

128. *Id.* at 946; *see* N.Y. COMP. CODES R. & REGS. tit. 23, § 200.2(p) (2023) ("Virtual Currency means any type of digital unit that is used as a medium of exchange or a form of digitally stored value. [V]irtual [C]urrency shall be broadly construed to include digital units of exchange that: have a centralized repository or administrator; are decentralized and have no centralized repository or administrator; or may be created or obtained by computing or manufacturing effort."); *see also* N.Y. COMP. CODES R. & REGS. tit. 23, §§ 200.2(q), 200.3 (2023).

129. Levitin, *supra* note 3, at 946.

130. *Id.*

131. *Id.*

132. *Id.* at 946-47.

133. *Id.* at 947.

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

exchanges should account for customer funds separately.[138] Further, the exchange should not use customer funds and clearly provide in the agreement with the customer that this is not a debtor-creditor relationship.[139] The guidance also states the exchange should structure the custodial arrangements such to benefit the customer's interests in their virtual currency.[140] Further, the cryptocurrency exchange may only enter into a debtor-creditor relationship with the customer if expressly agreed while the exchange must protect the customers' rights to their cryptocurrency if the exchange files for bankruptcy.[141]

D. NORTH DAKOTA'S CURRENT CRYPTOCURRENCY REGULATION & TREATMENT

One article ranks North Dakota fourth in the nation for creating a crypto economy, citing low costs and "smart regulation."[142] On June 8, 2022, the North Dakota Department of Financial Institutions issued a memorandum of guidance for digital currency directed toward the state's financial institutions.[143] The goal is to issue "guidance to help ensure risks are considered and mitigated."[144] The department indicates that "[cryptocurrency] is a quickly evolving area and [the] Federal oversight, regulation, or additional guidance may be forthcoming."[145] The memorandum outlines how the North Dakota Century Code section creating credit unions "does not explicitly authorize crypto custody services."[146] If credit unions in the state wish to offer members crypto custody services, the credit union must use a third party to offer the option to members.[147] Credit unions have a reputation for being extremely reliable, and cryptocurrencies do not have the same reputation, so credit unions should research in advance the reliability of crypto services to protect their reputation.[148] Additionally, credit unions must fully disclose the

138. *Id.*
139. *Id.*
140. *Id.*
141. *Id.* at 947-48.
142. Scott Cohn, *These 10 States Are Leading America in Creating a Crypto Economy*, CNBC (July 18, 2022, 1:01 PM), https://www.cnbc.com/2022/07/18/these-are-the-10-states-leading-americas-crypto-industry.html [https://perma.cc/6AS4-YN8Q].
143. Memorandum from the N.D. Dep't Fin. Insts. to N.D. State-Chartered Credit Unions (July 18, 2022).
144. *Id.*
145. *Id.*; *see generally* Exec. Order No. 14,067, *supra* note 83.
146. Memorandum from the N.D. Dep't Fin. Insts. to N.D. State-Chartered Credit Unions (July 18, 2022); *see generally* N.D. CENT. CODE § 6-06 (2023).
147. Memorandum from the N.D. Dep't Fin. Insts. to N.D. State-Chartered Credit Unions (July 18, 2022).
148. *Id.*

risks associated with cryptocurrency holdings to their members if they choose to offer cryptocurrency custody services through a third party.[149] Furthermore, credit unions have the same monitoring and reporting obligations for cryptocurrency as regular currency.[150] Since cryptocurrency transactions have the appeal of being anonymous, they tend to attract criminal activity.[151] Therefore, credit unions need to take steps to ensure that every crypto transaction they oversee is legal while followinging their reporting and monitoring obligations.[152] Credit unions may not accept virtual currency deposits because virtual currencies are not considered legal currency.[153] Additionally, credit unions may not invest their funds in virtual currencies.[154] If they choose to accept virtual currency as collateral, the credit union must thoroughly research the risks associated with the activity.[155]

The North Dakota legislature added another cryptocurrency regulation by signing HB 1082 into law, that amended the North Dakota Century Code to allow a Central Bank Digital Currency ("CBDC") and any other new currency adopted by governments into circulation.[156] This "[e]xcludes cryptocurrencies from the definition of money in order to eliminate competition against CBDC's."[157] A CBDC would allow banks to hold and issue a "U.S.-backed cryptocurrency . . . enabling the U.S. to enter the cryptocurrency market as a direct competitor with the cryptocurrencies already in the market."[158] The federal government is considering implementing a CBDC under President Biden's executive order.[159] If the federal government does so, North Dakota would automatically adopt it based on HB 1082's revisions to the Century Code.[160]

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149. *Id.*
150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *House Bill 1082 Relating to Central Bank Digital Currency*, N.D. CAN, https://ndcan.org/house-bill-1082 [https://perma.cc/4F8S-HGMD] (last visited June 1, 2024).
157. *Id.*; *see* N.D. CENT. CODE § 41-01-09(2)(y) (2023) ("'Money' means a medium of exchange that is currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization, or by agreement between two or more countries. The term does not include an electronic record that is a medium of exchange recorded and transferable in a system that existed and operated for the medium of exchange before the medium of exchange was authorized or adopted by the government.").
158. McKinlay, *supra* note 37, at 88.
159. *See generally* Exec. Order No. 14,067, *supra* note 83.
160. *House Bill 1082 Relating to Central Bank Digital Currency*, *supra* note 156.

IV. WHY THE NORTH DAKOTA LEGISLATURE SHOULD FOLLOW OTHER STATES' LEADS IN CRYPTOCURRENCY REGULATION

Cryptocurrency customers and investors are exposed to adverse risks when entering an agreement with a cryptocurrency exchange.[161] This occurs when the cryptocurrency exchange files for Chapter 11 bankruptcy. To achieve the Bankruptcy Code's goal of protecting consumers, states should take initiative to regulate cryptocurrency by creating balanced regulations that protect their consumers in the event a cryptocurrency exchange files for Chapter 11 bankruptcy.

A. PROMOTION OF FEDERAL POLICY INITIATIVES

North Dakota promoted federal policy initiatives by passing HB 1082, which circulates a CBDC if the federal government chooses to implement one.[162] President Biden provided for this to help regulate cryptocurrencies.[163] However, there is controversy about adopting a CBDC within the state, and surrounding states, such as South Dakota.[164] A group known as "North Dakota Can" published an article explaining why North Dakota should not have passed HB 1082.[165] In the article, North Dakota Can argues that CBDC would allow unprecedented federal government control over the American people's money because the government would have control over consumer spending as CBDC's are traceable.[166] South Dakota's governor, Kristi Noem, vetoed a similar 2023 bill introduced in South Dakota citing the threat it posed to the market freedoms.[167] Notwithstanding these current events, more desirable avenues may exist to achieve the goal of effective regulation of cryptocurrency.[168]

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161. Levitin, *supra* note 3, at 952.

162. *House Bill 1082 Relating to Central Bank Digital Currency*, *supra* note 156; N.D. CENT. CODE § 41-01-09(1)(y) (2023).

163. *See generally* Exec. Order No. 14,067, *supra* note 83.

164. *House Bill 1082 Relating to Central Bank Digital Currency*, *supra* note 152; *Cf.* Amanci Biraben, *South Dakota Gov's Veto of Cryptocurrency Regulations Upheld*, ASSOCIATED PRESS (Mar. 27, 2023, 2:51 PM), https://apnews.com/article/noem-veto-upheld-south-dakota-cryptocurrency-f6ee87ee2a68cd6460694504c87ec98c [https://perma.cc/3S4T-MHDA].

165. *House Bill 1082 Relating to Central Bank Digital Currency*, *supra* note 156.

166. *Id.*

167. *Id.*; Biraben, *supra* note 164.

168. *See generally* Exec. Order No. 14,067, *supra* note 83.

Generally, President Biden's executive order provides broad policy objectives for regulating cryptocurrency.[169] Furthermore, Congress and federal agencies have yet to take affirmative steps toward regulating cryptocurrency.[170] Although the executive order focuses on what the federal government can do to regulate cryptocurrency, states like North Dakota can use the policy priorities laid out in Section 2 to tailor cryptocurrency legislation to their needs.[171] Until the federal government takes affirmative steps to regulate cryptocurrency, the states have ample freedom to create legislation, and President Biden's executive order can provide states with a strong policy basis to create cryptocurrency legislation promoting their states' interests.[172]

B. ADOPTION OF CRYPTOCURRENCY REGULATION SIMILAR TO OTHER STATES

By providing a clear definition for cryptocurrency and allowing cryptocurrency exchanges to obtain an SPDI charter, Wyoming is paving the way to regulate cryptocurrency while encouraging cryptocurrency businesses to come to the state.[173] Wyoming's legislative intiatives create more protections for consumers and their investments while insulating cryptocurrency businesses from operational risk.[174] This not only incentivizes cryptocurrency businesses to set up operations in the state, but also allows consumers to invest in cryptocurrency while mitigating their risk.[175] To further North Dakota's goal of encouraging cryptocurrency companies to set up business in the state, the legislature should follow Wyoming's lead by passing similar legislation.[176] Using legislation to define cryptocurrency and creation of SPDI charters is only one way North Dakota can get ahead of the game and become a leader in cryptocurrency regulation like Wyoming.[177]

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169. *See* discussion *supra* Section III.B; *see also* Exec. Order No. 14,067, *supra* note 83.

170. *See generally* Exec. Order No. 14,067, *supra* note 83; Memorandum from the N.D. Dep't Fin. Insts. to N.D. State-Chartered Credit Unions (July 18, 2022); U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 97.

171. *See generally* Exec. Order No. 14,067, *supra* note 83.

172. *See generally id.*; Memorandum from the N.D. Dep't Fin. Insts. to N.D. State-Chartered Credit Unions (July 18, 2022); *supra* note 143. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 97.

173. Melissa Pereira, *Regulatory Landscape in Wyoming and Wyoming's Leadership in Cryptocurrency*, B.U. SCH. L. REV. BANKING & FIN. L. (Mar. 28, 2022), https://www.bu.edu/rbfl/2022/03/28/regulatory-landscape-in-wyoming-and-wyomings-leadership-in-cryptocurrency/ [https://perma.cc/A7QZ-4382].

174. *Id.*

175. *Id.*

176. *Burgum One of World's Largest Data Centers to Locate in Williston Area as Industry Targets Growth in ND*, N.D. OFF. GOVERNOR (Jan. 26, 2022, 11:20 AM), https://www.governor.nd.gov/news/burgum-one-worlds-largest-data-centers-locate-williston-area-industry-targets-growth-nd [https://perma.cc/8DW8-BMJF]; *See* discussion *supra* Section III.C.

177. *See* discussion *supra* Section III.C.

In addition to Wyoming's intiatives in cryptocurrency regulations, North Dakota could follow New York's example by creating Bitlicenses or limited purpose trust companies.[178] Through enactment of these statutes, New York has provided a strong example for cryptocurrency industry compliance.[179] Cryptocurrency companies were skeptical when New York first released their cryptocurrency regulations because "the requirements [were] overly expensive and onerous."[180] However, more cryptocurrency companies have sought approval for Bitlicenses and limited purpose trust company status because these regulatory methods demonstrate the government is willing to support them.[181] This provides consumers with the sense their investments in cryptocurrency are safe.[182] Protecting consumers should be the top priority in creating cryptocurrency regulations. New York provides comprehensive regulatory methods that achieve this priority.[183] While North Dakota is much smaller than New York, Governor Burgum and the state want to encourage cryptocurrency companies to do business in the state.[184] Although New York's cryptocurrency regulation is more extensive than Wyoming's regulation, North Dakota could borrow from each approach to protect consumers wishing to invest in cryptocurrency.[185]

Until the federal government decides to take affirmative steps to regulate cryptocurrency, "individual states, persons, and businesses are left to make their own choices about using cryptocurrency as collateral for loans, recovering it for the benefit of creditors in bankruptcy, or seizing it as recovery for monetary judgments."[186] New York and Wyoming offer potential solutions that may guide North Dakota in regulating cryptocurrency to protect consumers when a cryptocurrency exchange files for Chapter 11 bankruptcy.[187] The first step North Dakota should take in regulating cryptocurrency is to pass a statute similar to Wyoming, by defining categories of digital currencies.[188] Furthermore, North Dakota could establish an SPDI like Wyoming to further

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178. *See* discussion *supra* Section III.C.

179. Cryptopedia Staff, *Crypto Regulation in New York A Benchmark of Progress*, CRYPTOPEDIA (Dec. 2, 2021), https://www.gemini.com/cryptopedia/new-york-cryptocurrency-regulations [https://perma.cc/F532-PMP8].

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*; *see* discussion *supra* Section III.C.

184. *Burgum One of World's Largest Data Centers to Locate in Williston Area as Industry Targets Growth in ND*, *supra* note 176.

185. *See* discussion *supra* Section III.C.

186. McKinlay, *supra* note 37, at 116.

187. *See* discussion *supra* Section III.C.

188. *See* discussion *supra* Section III.C; WYO. STAT. ANN. § 34-29-101(a)(ii)-(iv) (West 2023) North Dakota could model its definitions after this section of Wyoming state law.

its goal of attracting cryptocurrency business to the state.[189] While Wyoming has not given many SPDI charters, North Dakota could still adopt this idea, or it could adopt charters similar to New York Bitlicenses or the limited purpose trust.[190] Ultimately, North Dakota lawmakers cannot wait for the federal government to take regulatory action, so considering and potentially implementing other states' legislative approaches will be the most beneficial in protecting its consumers.

V. CONCLUSION

Consumers face significant risks when they invest their assets in cryptocurrency exchanges. If the cryptocurrency exchange files for Chapter 11 bankruptcy, then consumers face the risk they may not recoup their assets. To protect consumers and further the goals of the Bankruptcy Code, the state government must begin to consider regulatory action that can limit the negative effects a cryptocurrency exchange has on consumers. Special business charters and licenses help regulate cryptocurrency exchanges and protect consumers. Consumers who wish to invest in cryptocurrency are currently unprotected. Therefore, the North Dakota legislature needs to take action to protect its constituents when a cryptocurrency company files for Chapter 11 bankruptcy.

*Erin Weightman**

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189. *See* discussion *supra* Section III.C; Cohn, *supra* note 142.
190. *See* discussion *supra* Section III.C.

*2025 J.D. Candidate at the University of North Dakota School of Law. First, I would like to thank Professor Alexandra Sickler at the UND School of Law for advising me on topic selection. I would also like to express my gratitude to the NORTH DAKOTA LAW REVIEW for the offer of publication and extensive efforts contributed to my Note during the editing process. Finally, I would like to thank my family and friends, especially my best friend, Brady, for the constant support and encouragement as I continue to pursue my legal education.