

Facing Celsius Clawbacks? Key Approaches for Hong Kong's Account Holders

A. Background

Celsius Network LLC (“Celsius”), a major cryptocurrency lender founded in 2017 in New Jersey, United States, allowed users to deposit various cryptocurrencies such as Bitcoin and Ethereum to earn interest and to take out loans secured by their virtual assets. By May 2022, Celsius had lent out US\$8 billion and managed nearly US\$12 billion in assets. However, in June 2022, Celsius paused all transfers and withdrawals due to “extreme market conditions”, and subsequently filed for Chapter 11 bankruptcy on 13 July 2022, revealing a US\$1.2 billion deficit and substantial liabilities to its account holders.

As being discovered during the bankruptcy proceedings, Celsius was accused of running a Ponzi scheme and deceptive practices. In July 2023, the Federal Trade Commission settled with Celsius, banning it from handling consumer assets and charging it with misleading account holders. The settlement included a US\$4.7 billion fine but such fine was suspended to allow for the return of remaining assets to consumers in bankruptcy proceedings. Former CEO, Alex Mashinsky, was charged with fraud for misleading customers.

Celsius exited bankruptcy on 31 January 2024 with a restructuring plan approved by creditors, distributing over US\$3 billion in cryptocurrency and fiat, and creating a new Bitcoin mining company (namely, Ionic Digital, Inc.) owned by creditors. Celsius has committed to partial repayments to creditors with cryptocurrency and stock in the new company.

There were certain Celsius’s account holders who withdrew more than US\$100,000 of assets in the 90 days before Celsius’s bankruptcy filing on 13 July 2022. On 9 January 2024, Celsius administrators filed an intent to reclaim funds from those account holders who withdrew more than US\$100,000 in value. These actions were initiated under *Section 547 – Preference, Chapter 11 of the United States Code* (the “**Bankruptcy Code**”) – commonly known as “Clawback Actions” (the “**Clawback Actions**”) – and aim to recover a portion of Celsius’s funds, with affected account holders required to pay back the amount withdrawn.

It has come to our attention that there are residents in Hong Kong, who have recently been served with US Court documents related to the Clawback Action with the assistance of the Bailiff Section in Hong Kong Judiciary. As these Clawback Actions unfold, it is essential for the affected individuals to understand the possible approaches available to contest these claims.

B. Possible Approaches of defending the Clawback Action

If you are one of those who have received the US Court documents for the Clawback Action, it is crucial that you do not just disregard those documents. Ignoring them may lead to a default judgment, where the court could rule in favour of Celsius’s administrators in your absence without any evidence from you. With such judgment, Celsius’s administrators could then pursue enforcement actions against you in Hong Kong or even in other jurisdictions.

Therefore, you should seek legal advice and make sure to respond within the specified time frame mentioned in the US Court documents, including submitting an answer to the complaint putting up your defence against Celsius’s claims, for which you may consider several approaches below (which are not intended to be exhaustive).

- (1) **The virtual assets were never part of Celsius’s estate:** Section 541(a)(1) of the Bankruptcy Code defines what constitutes property of the debtor’s estate to include “all legal or equitable interests of the debtor in property as of the commencement of the case.” Accordingly, for Celsius to claim the

withdrawn amount from you as an account holder, it must demonstrate that the withdrawn amount was part of Celsius's estate. According to Celsius terms of use dated 15 April 2022 (the "**Terms of Use**"),¹ the Celsius platform has two types of accounts: the "Earn Service account" and the "Custody Service account". For the Earn Service account, under the Terms of Use,² if you are using the Earn Service, "*you will lend your Eligible Digital Assets to Celsius and grant Celsius all rights and title to such Digital Assets, for Celsius to use in its sole discretion while using the Earn Service*". Thus, such assets were presumptively property of the bankruptcy estate.³ By contrast, Celsius's Custody Service account is more akin to a traditional deposit or custodial account. Under the Terms of Use, the title of assets shall at all times remain with the accounts holder and not transferred to Celsius.⁴ Accordingly, at first glance, given that title purportedly remains with the account holder and the assets may not be used freely by Celsius, it is arguable that virtual assets in Custody Service accounts would seem to fall outside of the ambit of Celsius's estate.

- (2) **Ordinary Course of Business ("OCB") Defence:**⁵ The OCB defence focuses on the regularity of the transactions between you and Celsius. If the withdrawals were part of the normal business operations and consistent with historical dealings, this defence may be invoked. You as an account holder need to provide evidence of regular, recurring transactions, portraying the withdrawals as part of routine business practices rather than out-of-the-ordinary events, hence establishing a historical pattern of similar transactions could significantly strengthen this defence. The determination of ordinariness is highly fact sensitive and would likely include considerations such as the length of the relationship with Celsius and the nature and number of withdrawal transactions made by you. Therefore, this OCB defence needs to be analysed on an individual basis.
- (3) **Good Faith Defence:**⁶ The Good Faith defence allows you to argue that you withdrew your virtual assets from Celsius in good faith. You must show that you were not aware of Celsius's financial instability or there are no fraudulent intentions behind the withdrawals. If it can be proven that you acted in honesty and without deceit, whilst also providing value in return for the assets, this defence might be invoked to protect you from the Clawback Action. You might try to evoke this defence, subject to the review of the transactional documents.
- (4) **Contemporaneous Exchange for Value Defence:**⁷ Additionally, the Contemporaneous Exchange for Value defence applies when the transfer was intended as a substantially contemporaneous exchange for new value given to Celsius. You must show that the withdrawals were part of an immediate and reciprocal transaction, meaning that you provided something of equal value to Celsius at the same time as the asset withdrawal. Proving this requires solid documentation and evidence of simultaneous value exchanges.
- (5) **Subsequent New Value Defence:**⁸ The Subsequent New Value defence allows you to offset the amount of a potentially preferential transfer by showing you provided new value to Celsius **after** the initial transaction. This could mean providing more assets, services, or something beneficial to Celsius that can be quantified. This defence hinges on the timeline of transactions and the nature of the

1 The Terms of Use may be different from the version being applicable to individual account holders.

2 See Clause 4D of the Terms of Use

3 See also Memorandum Opinion and Order Regarding Ownership of Earn Account Assets, In re Celsius Network LLC, No. 22-10964 (MG) (Bankr. S.D.N.Y. Jan. 4, 2023), ECF No. 1822

4 Clause 4B of the Terms of Use

5 Section 547(c)(2) of the Bankruptcy Code

6 Section 548(c) of the Bankruptcy Code

7 Section 547(c)(1) of the Bankruptcy Code

8 Section 547(c)(4) of the Bankruptcy Code

subsequent value provided, making it essential for you to have detailed records of all interactions post-withdrawal.

C. Observations

Account holders facing Clawback Actions taken out by Celsius have several possible approaches. Consulting with a lawyer who specializes in cryptocurrency bankruptcy law is a crucial first step to review the situation, assess potential defences such as those mentioned above, and providing a pragmatic approach to resolving these claims efficiently. Additionally, gathering and organising all relevant documentation, such as transaction records, is essential to formulate a defence strategy.

Exploring the settlement option is also a strategic move worth considering. Depending on the strength of the defence of an individual case (assuming there is one), you may engage in a settlement negotiation with the Celsius administrators, and it could currently be expected that the Clawback Action may be able to be settled at a lower percentage at this early stage. Though this may not be an insignificant amount, it avoids prolonged legal battle and potential judgment and subsequent enforcement against your assets. If settlement can be reached, you can mitigate immediate financial burden and the uncertainty of litigation outcomes. More importantly, if the US Court documents are undealt with, and a default judgment is being entered against you, it would then be much harder (and even if possible, at all) to discharge it, and would involve a much higher settlement sum (and possibly legal costs) to resolve the case.

At Henry Yu & Associates, our experienced legal team is well versed in the intricacies of virtual asset-related laws and regulations and provides tailored advice to clients in protecting their interests in virtual asset-related disputes. Please do get in touch with our team members at hyu@lylawoffice.com or (+852) 2115-9525 if you have any views on the above or would like to further discuss any of the issues raised in this Client Alert more generally.

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