

## Overview Report – Quadriga CX

QuadrigaCX was the business name for a BC numbered company (0984750 B.C. Ltd.) that operated a cryptocurrency exchange platform from December 2013 to February 2019. It allowed users to store, buy and sell various cryptocurrencies from its online operating platform through its website at [www.quadrigacx.com](http://www.quadrigacx.com). It garnered attention on the Canadian stage in early years by installing a Bitcoin ATM in Vancouver,<sup>1</sup> announcing plans to go public,<sup>2</sup> and developing a significant client base in Canada.

Quadriga later gained international attention when, on January 14, 2019, it announced its founder Gerald Cotten had died in India in December 2018, leaving Quadriga owing 76,000 clients a combined \$215 million.<sup>3</sup> Major Canadian news outlets picked up the story,<sup>4</sup> as did international outlets like Bloomberg,<sup>5</sup> BBC,<sup>6</sup> and others. Most reported that the founder of Quadriga had died without sharing the passwords to the cold storage of virtual assets held by Quadriga, which meant that the client assets recorded in that storage were inaccessible.<sup>7</sup> However, the Ontario Securities Commission later found that that inaccessibility of cold storage did not explain the shortfall at all; rather, Quadriga CX had been operating as a classic Ponzi scheme, paying off older debts to clients with new incoming funds, and even before Mr. Cotten's death, Quadriga simply did not have sufficient assets to support its clients' holdings.<sup>8</sup>

On February 5, 2019, the three companies that operated Quadriga CX were granted protection from creditors by the Nova Scotia Supreme Court.<sup>9</sup> Ernst & Young was

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<sup>1</sup> Stephen Hui, "Geek Speak: Gerald Cotten, CEO of Quadriga CX," *The Georgia Straight*, 14 February 2014, online: <<https://www.straight.com/life/587456/geek-speak-gerald-cotton-ceo-quadriga-cx>>

<sup>2</sup> Diana Ngo, "QuadrigaCX to Become World's First Publicly Traded Bitcoin Exchange", *Coin Telegraph*, 4 March 2015, online: <<https://cointelegraph.com/news/quadrigacx-to-become-worlds-first-publicly-traded-bitcoin-exchange>>

<sup>3</sup> Ontario Securities Commission, "QuadrigaCX: A Review by Staff of the Ontario Securities Commission" (April 14, 2020) online: <<https://www.osc.gov.on.ca/quadrigacxreport/index.html>> (the "OSC Report"), p 3

<sup>4</sup> Erica Alini, "How crypto exchange QuadrigaCX lost access to \$190 million of customers' money", *Global News*, 5 February 2019, online: <<https://globalnews.ca/news/4914774/quadrigacx-creditor-protection-crypto-exchange/>>;

Michael MacDonald, "An insider's view of the Quadriga meltdown: 'It's kinda devastating'", *National Post*, 18 February 2019, online: <<https://nationalpost.com/pmnn/news-pmn/canada-news-pmn/an-insiders-view-of-the-quadriga-meltdown-its-kinda-devastating>>;

Joe Castaldo and Alexandra Posadzki, "Before Quadriga: How shady ventures in Gerald Cotten's youth led to the creation of his ill-fated cryptocurrency exchange," *The Globe and Mail*, 22 November 2019, online: <<https://www.theglobeandmail.com/business/article-before-quadriga-how-shady-ventures-in-gerald-cottens-youth-led-to/>>;

Joe Castaldo, Alexandra Posadzki, Jessica Leeder and Lindsay Jones, "Crypto chaos: From Vancouver to Halifax, tracing the mystery of Quadriga's missing millions," *The Globe and Mail*, 8 February 2019, online: <<https://www.theglobeandmail.com/business/article-crypto-chaos-from-vancouver-to-halifax-tracing-the-mystery-of/>>

<sup>5</sup> Doug Alexander, "Crypto CEO Dies Holding Only Passwords That Can Unlock Millions in Customer Coins," *Bloomberg*, 4 February 2019, online: <<https://www.bloomberg.com/news/articles/2019-02-04/crypto-exchange-founder-dies-leaves-behind-200-million-problem>>

<sup>6</sup> BBC, "Quadriga: Lawyers for users of bankrupt crypto firm seek exhumation of founder," *BBC*, 13 December 2019, online: <<https://www.bbc.com/news/world-us-canada-50751899>>

<sup>7</sup> Ibid

<sup>8</sup> OSC Report

<sup>9</sup> IN THE MATTER OF: Application by Quadriga Fintech Solutions Corp., Whiteside Capital Corporation and 0984750 B.C. Ltd. dba Quadriga CX and Quadriga Coin Exchange (collectively referred to as the "Applicants"), for relief under the Companies' Creditors Arrangement Act, Nova Scotia Supreme Court file no. 48742, Fifth Report of the Monitor, filed June 19, 2019, online: <blob:https://documentcentre.ey.com/a4d9701e-ba0b-47b6-8940-4677de0f7cf9> ("Fifth Report of the Monitor")

appointed as monitor for the CCAA proceeding on February 5, 2019, and became trustee in bankruptcy on April 15, 2019.<sup>10</sup>

On May 1, 2019, Ernst & Young, acting in its capacity as bankruptcy trustee, delivered the Trustee's Preliminary Report. On June 19, 2019, acting in its capacity as monitor, Ernst & Young delivered its Fifth Report. On April 14, 2020, the Ontario Securities Commission ("OSC"), which had been investigating QuadrigaCX, released a report detailing its findings.<sup>11</sup>

Ernst & Young and the OSC found that despite hiring staff to work on technical aspects of the trading platform, Mr. Cotten alone retained control of the company's fiat and crypto assets.<sup>12</sup>

While the platform grew slowly between 2013 and 2016, from 2016 to 2017 its active client base grew over 2,000%.<sup>13</sup> Over 95% of Q's clients identified as Canadian residents and the vast majority of client deposits and trades were in either Canadian dollars or Bitcoin<sup>14</sup> The OSC also found that many clients also placed a great deal of trust in Quadriga as a company, expressing their belief that because it was a Canadian company, it must have proper oversight and not understanding the risk the unregistered platform posed to their assets.<sup>15</sup>

The reports from Ernst and Young and the investigation by the OSC revealed there were a number of problems with the way Quadriga handled its clients' assets, both virtual and fiat.<sup>16</sup> Those issues included holding all client assets in a central Quadriga account instead of in separate client accounts, holding client assets on other virtual asset trading platforms or in hot wallets, shifting client funds onto other platforms without their knowledge or consent, using client funds to speculate, problems with obtaining secure banking relationships which led to the use of an assortment of third party payment processors in Canada and internationally, excessive use of cash, failing to maintain boundaries between client assets and business administration assets, misappropriating funds to convert to support Mr. Cotten's personal lifestyle, lack of oversight, failing to maintain records of either virtual or fiat balances, etc. The OSC report also found that Mr. Cotten engaged in trading on the Quadriga CX platform for his own benefit under numerous aliases, manipulating the platform's internal ledger to give himself fake assets, and using assets of other clients to cover the difference.

According to the OSC report, these practices were able to remain hidden when the price of virtual assets rose sharply in 2017, and customers flocked to Quadriga. When the price

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<sup>10</sup> In the matter of the bankruptcies of Quadriga Fintech Solutions Corp., Whiteside Capital Corporation and 0984750 B.C. Ltd. of the City of Halifax, in the Province of Nova Scotia, Trustee's Preliminary Report, dated May 1, 2019, online: <blob:https://documentcentre.ey.com/2a7e82b8-a90e-4bce-bb4d-ef8e2e1d2625> ("Trustee's Preliminary Report").

<sup>11</sup> OSC Report, p 1

<sup>12</sup> OSC Report, pp. 9-10

<sup>13</sup> OSC Report, pp. 10

<sup>14</sup> OSC Report, p. 11

<sup>15</sup> OSC Report, p. 10

<sup>16</sup> OSC Report, pp. 12-16; Fifth Monitor Report pp. 6-8

of virtual assets began to fall in 2018, Quadriga became unable to meet client withdrawal requests. This was coupled with the court-ordered freeze of \$26million of assets of one of its third-party payment processors, and the mysterious disappearance of \$12million of assets from another payment processor.<sup>17</sup>

In total, the Ontario Securities Commission found that of the \$215 million that Quadriga owed:<sup>18</sup>

- \$46 million was recovered by Ernst & Young;
- \$115 million was lost due to Cotten's trading losses on the Quadriga platform,
- \$28 million was lost by Cotten trading on other crypto asset trading platforms,
- \$2 million was unaccounted for from the money Cotten misappropriated for his own personal living expenses,
- \$1 million was attributed to Quadriga's estimated operating losses, such as the fees owed to contractors and payment processors; and
- \$23 million was unaccounted for.

Ernst & Young also recovered \$12 million worth of assets was recovered by Ernst & Young from Mr. Cotten's spouse.

The RCMP and FBI have confirmed they have opened investigations into Quadriga.<sup>19</sup>

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<sup>17</sup> OSC Report p. 20-22

<sup>18</sup> OSC Report pp. 25-26

<sup>19</sup> Michael MacDonald, "RCMP, FBI two of four agencies investigating former crypto exchange Quadriga," *Global News*, 29 August 2019, online: < <https://globalnews.ca/news/5830003/quadriga-crypto-fbi-rcmp>