Pratt's Journal of Bankruptcy Law

LexisNexis

Pratt's Journal of Bankruptcy Law

LexisNexis®

Editor-in-Chief, Editor & Board of Editors

The Need for Clarity Regarding the Classification and Valuation of Cryptocurrency in Bankruptcy Cases

By Brad M. Kahn, Rachel Biblo Block, and Joseph E. Szydlo[*]

In light of cryptocurrencies' increasing popularity and prevalence, it will not be long before bankruptcy courts are required to rule on issues pertaining to cryptocurrencies, which may lead to some of the most interesting and complex restructurings yet. The authors of this article discuss cryptocurrency and blockchain in bankruptcy.

In early 2018, in written testimony to a Senate committee, the then-chair of the Commodities Futures Trading Commission (the "CFTC") acknowledged both the unknowns and importance of virtual currencies, like cryptocurrencies:

> We are entering a new era in world financial markets. As we saw with the development of the Internet, we cannot put the technology genie back in the bottle. Virtual currencies mark a paradigm shift in how we think about payments, traditional financial processes, and engaging in economic activity. Ignoring these developments will not make them go away, nor is it a responsible regulatory response. The evolution of these assets, their volatility, and the interest they attract from a rising global millennial population demand serious examination.[1]

The CFTC chair's advice on virtual currencies resonates particularly well in the bankruptcy context where bankruptcy courts have been reluctant to make determinative rulings with respect to the classification and valuation of cryptocurrencies. Once obscure, cryptocurrencies have become a popular asset group. In early May 2021, the market capitalization of known cryptocurrencies was more than $2.3 trillion.[2] Despite this growing popularity, many questions concerning the treatment of cryptocurrency in bankruptcy remain unanswered.

---

[*] Brad M. Kahn (bkahn@akingump.com) is a partner at Akin Gump Strauss Hauer & Feld LLP advising clients in complex corporate restructurings and bankruptcies, including multijurisdictional and cross-border matters. Rachel Biblo Block (rbibloblock@akingump.com) is a counsel at the firm focusing on Chapter 11 proceedings, bankruptcy litigation, and other bankruptcy-related matters. Joseph E. Szydlo (jszydlo@akingump.com) is an associate at the firm focusing on bankruptcy and financial restructuring matters.

[1] Written Testimony of Chairman J. Christopher Giancarlo before the Senate Banking Committee (Feb. 6, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo37.

[2] CoinMarketCap, https://coinmarketcap.com/ (last visited May 5, 2021).

CRYPTOCURRENCY AND BLOCKCHAIN

To understand how bankruptcy courts may treat and value cryptocurrency, it is important to understand generally what cryptocurrency is and the key characteristics of widely used coins and tokens. Many differences exist among crypto-assets and cryptocurrencies, and a single, generally accepted framework for the classification of crypto-assets and cryptocurrencies does not currently exist.[3]

Cryptocurrency is a medium of exchange that is created and stored electronically in a digital decentralized ledger (a "blockchain") that employs encryption techniques to control the creation of units and verify the transfer of units.[4] The decentralized ledger, or blockchain, is maintained and updated in real time.[5] When someone requests a transaction, the transaction is broadcast to a network of computers, called nodes. The network of nodes validates the transaction using known algorithms and, once validated, the transaction is combined with other transactions to create a new block of data for the ledger that is permanent and unalterable. The process of validating transactions is called "mining," and the first node to validate a transaction is rewarded with a "block reward." For example, the first node to validate a Bitcoin transaction will earn bitcoins as a reward.

COINS AND TOKENS

The cryptocurrency system consists of coins and tokens (although some do not consider tokens to be cryptocurrency). No universally accepted definition exists for "coins" or "tokens," and some use the terms interchangeably; however, a "coin" generally refers to a cryptocurrency created on its own native network with its own separate, standalone blockchain. For example, bitcoins are created on Bitcoin's blockchain.

---

[3] *Cryptographic assets and related transactions: accounting considerations under IFRS*, PWC (December 2019) at 3, https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/cryptographic-assets-related-transactions-accounting-considerations-ifrs-pwc-in-depth.pdf.

[4] *See, e.g.*, Allison Morrow, *A beginner's guide to crypto lingo*, CNN (Apr. 26, 2021 at 3:41 p.m.), https://www.cnn.com/2021/04/26/investing/crypto-definitions/index.html.

[5] Ameer Rosic, *What is Blockchain Technology? A Step-by-Step Guide for Beginners*, Block-geeks, https://blockgeeks.com/guides/what-is-blockchain-technology/.

A "token" generally refers to a cryptocurrency built on top of an existing blockchain.[6] For example, many tokens utilize Ethereum's blockchain, and in effect, this creates a subledger for each of those tokens on Ethereum's network.[7]

Bitcoin and Ether, the coin created on Ethereum's network, currently dominate the cryptocurrency market, collectively accounting for more than 62 percent of all cryptocurrencies by market capitalization.[8] Bitcoin and Ethereum directly power or serve as a template for the majority of cryptocurrencies' blockchains, with Bitcoin being the first cryptocurrency and first major blockchain.[9] As of May 5, 2021, there were 18,700,706 bitcoins in circulation, with a market price of $56,924.05 per bitcoin.[10] Created in 2015, Ethereum uses a different blockchain technology than Bitcoin.[11] As of May 5, 2021, there were 115,753,102 Ether in circulation, selling at a market price of $3,457.18 per Ether.[12]

Many of the most widely circulated tokens utilize Ethereum's blockchain.[13] Tokens, unlike coins, are not universally considered to be cryptocurrency because not all tokens function like money.[14] Popular types of tokens include non-fungible tokens ("NFTs"), utility tokens, and security tokens.

---

[6] Stephen McKeon, *What is blockchain token?*, PBS (Aug. 5, 2020 at 1:22 p.m.), https://www.pbs.org/newshour/science/what-is-a-blockchain-token.

[7] *Id.*

[8] CoinMarketCap, https://coinmarketcap.com/ (last visited May 5, 2021).

[9] *See* Vinay Gupta, *A Brief History of Blockchain*, Harvard Business Review (Feb. 28, 2017), https://hbr.org/2017/02/a-brief-history-of-blockchain; Marco Iansiti & Karim R. Lakhani, *The Truth About Blockchain*, Harvard Business Review (Jan.-Feb. 2017), https://hbr.org/2017/01/the-truth-about-blockchain; *Money is no object: Understanding the evolving cryptocurrency market*, PWC (2015), https://hbr.org/2017/02/a-brief-history-of-blockchain; Ryan Haar, *Bitcoin: The First Cryptocurrency Is As Volatile As It Is Valuable*, NextAdvisor (May 19, 2021), https://time.com/nextadvisor/investing/cryptocurrency/what-is-bitcoin/; CoinMarketCap, https://coinmarketcap.com/tokens/views/all/ (last visited May 24, 2021).

[10] CoinMarketCap, https://coinmarketcap.com/ (last visited May 5, 2021).

[11] Ryan Browne, Ethereum: *What is it and how is it different from bitcoin?*, CNBC (May 10, 2021), https://www.cnbc.com/2021/05/10/ethereum-what-is-it-and-how-is-it-different-to-bitcoin.html.

[12] CoinMarketCap, https://coinmarketcap.com/ (last visited May 5, 2021).

[13] *See* CoinMarketCap, https://coinmarketcap.com/tokens/views/all/ (last visited May 11, 2021).

[14] *Cryptographic assets and related transactions: accounting considerations under IFRS*, PWC (December 2019) at 3–4, https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/cryptographic-assets-related-transactions-accounting-considerations-ifrs-pwc-in-depth.pdf.

NFTs are digital content linked to a blockchain but are unique and not mutually interchangeable. Therefore, no two NFTs are the same, and each NFT serves as proof of ownership over something. "NFTs create scarcity among otherwise infinitely available assets."[15] For example, NBA Top Shot is an NFT marketplace with digitized professional basketball highlights for purchase.[16] Each "Top Shot" has a unique edition number and size and a limited number of Top Shot moments are released.[17]

Utility tokens provide users with access to a product or service. The holder of a utility token can use it to make purchases, usually within an online application. Conceptually, a utility token is similar to a gift card to a specific store.[18] For example, FUN tokens are digital chips for use in Funfair's online gaming platform.[19] All services and games on the platform use FUN tokens.

Security tokens are similar to traditional securities, typically derive value from an external, tradable asset (such as gold), and can provide an economic stake in a legal entity.[20] Security tokens are designed to be investments and are subject to federal securities laws and regulations. For example, SPiCE is a venture capital fund that invests in companies in the blockchain/tokenization industry, and the LP interests in SPiCE were tokenized.[21]

CRYPTOCURRENCY AND THE BANKRUPTCY CODE

There is no generally accepted framework or methodology for the classification or valuation of cryptocurrencies. Academic debate regarding the treatment of cryptocurrency in bankruptcy has focused on whether cryptocur-

---

[15] Jazmin Goodwin, *What is an NFT? Non-fungible tokens explained*, CNN (Mar. 17, 2021 at 1:42 p.m.), https://www.cnn.com/2021/03/17/business/what-is-nft-meaning-fe-series/index. html.

[16] Jon Sarlin, *NBA Top Shot customers can't get their money out. Experts are confounded*, CNN (Apr. 27, 2021), https://www.cnn.com/2021/04/27/investing/top-shot-withdrawal-nba-nft/index. html.

[17] NBA Top Shot, https://nbatopshot.com/about (last visited May 25, 2021).

[18] Ahiza Garcia, *Beyond bitcoin: the other cryptocurrencies you should know too*, CNN (Nov. 20, 2018 at 3:03 p.m.), https://www.cnn.com/2018/11/20/tech/bitcoin-cryptocurrency-types.

[19] FUNFAIR TECHNOLOGIES, https://funfair.io/bitcoin-casino/ (last visited May 5, 2021).

[20] *See* Rajarshi Mitra, *Utility Tokens vs Security Tokens: Learn The Difference—Ultimate Guide*, BLOCKGEEKS, https://blockgeeks.com/guides/utility-tokens-vs-security-tokens/; *Cryptographic assets and related transactions: accounting considerations under IFRS*, PWC (December 2019) at 4, https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/cryptographic-assets-related-transactions-accounting-considerations-ifrs-pwc-in-depth.pdf.

[21] SPiCE, https://spicevc.com/about.html (last visited May 5, 2021).

rencies should be classified as currencies or commodities.[22] Because certain Bankruptcy Code provisions distinguish currencies from commodities and may offer different protections to financial transactions depending on the nature of the relevant asset being transferred, the ultimate classification can impact the treatment of the underlying transaction in a bankruptcy case, particularly in the avoidance context.

Limitations on Avoidance Actions

Avoidance powers are codified in Chapter 5 of the Bankruptcy Code, and in the event a transaction is avoided, Bankruptcy Code Section 550 allows the trustee[23] to recover the property transferred or, if the court so orders, the value of such property from the transferee.

Avoidance powers, however, are not absolute, and Bankruptcy Code Section 546 sets forth limitations on the trustee's ability to avoid certain transactions. Among other things, Section 546 provides protection from avoidance for "swap agreements" involving both currencies and commodities.

Specifically, pursuant to Section 546(g), a trustee "may not avoid a transfer, made by or to (or for the benefit of) a swap participant or financial participant, under or in connection with any swap agreement and that is made before the commencement of the case," except where the transfer involved actual fraud.

Bankruptcy Code Section 101(53B)(A)(i)(III) defines a "swap agreement" to include "a currency swap, option, future, or forward agreement." At a high level, currency swaps involve the exchange of one currency for another. A common transaction within the cryptocurrency space is the exchange of bitcoins for U.S. dollars, and this kind of transaction may fit naturally within the currency swap construct. This seemingly natural fit has led some scholars to suggest that, if cryptocurrency is classified as currency under the Bankruptcy Code, then "contracts in which individuals exchanged [] [cryptocurrencies] for

---

[22] *See, e.g.*, Matthew D. Rayburn, *Bitcoin When the Bank Breaks: Uncertainty in the Treatment of Bitcoin & Other Cryptocurrencies in the Face of Bankruptcy*, 16 NYU J.L. & BUS. 257 (2019); Mary E. Maginnis, *Money for Nothing: The Treatment of Bitcoin in Section 550 Recovery Actions*, 20 U. PA. J. BUS. L. 485 (2018); Erin Jane Illman & Robert A. Cox Jr., *Bitcoin and bankruptcy: Why creditors and bankruptcy practitioners need to understand cryptocurrencies*, WESTLAW (Dec. 14, 2017); Chelsea Deppert, *Bitcoin and Bankruptcy: Putting the Bits Together*, 32 EMORY BANKR. DEV. J. 123 (2015).

[23] Pursuant to Bankruptcy Code Section 1107(a), in a case filed under Chapter 11, a debtor-in-possession has most of the same rights, powers, and duties as a trustee, and can recover property pursuant to Bankruptcy Code Section 550. *See* 11 U.S.C. § 1107(a).

dollars or other currencies, . . . might be classified as 'swaps' " and protected from the trustee's avoidance powers.[24]

These scholars submit that the same protections are not automatically granted to transactions involving commodities. Bankruptcy Code Section 101(53B)(A)(i)(VII) defines "swap agreement" to include any agreement that is a "commodity swap, option, future, or forward agreement."

At a high level, commodity swaps involve the exchange of cash flows that are dependent upon an underlying commodity but not the exchange of that underlying commodity. Therefore, if bitcoins are a commodity, then the common transaction of exchanging bitcoins—the underlying commodity—for U.S. dollars may not fit within the commodity swap construct. This position, however, is not universally accepted, and other scholars believe the answer is not so straightforward because of the Bankruptcy Code's broad definition of swap agreement.[25]

Additionally, Bankruptcy Code Section 546(e) prohibits the avoidance of a transfer that is a margin payment or settlement payment[26] made by, to, or for the benefit of a "forward contract merchant" (someone or some entity engaged in the business of entering into forward contracts in a commodity) in connection with a "forward contract," except where the transfer involved actual fraud. Bankruptcy Code Section 101(25)(A) defines a "forward contract" as a contract for the purchase, sale, or transfer of a commodity (or any similar good, article, service, right, or interest) with a maturity date more than two days after the parties entered into the contract.

The bounds for what qualifies as a "forward contract" under the Bankruptcy Code have not been absolutely delineated, and the definition appears quite broad. Some scholars submit that to be entitled to protection, transactions involving commodities must constitute a forward contract, but "it may be difficult for any transaction or agreements with the transfer of bitcoins [or other cryptocurrencies] to meet the definition of a forward contract."[27] These scholars do not offer detailed explanations in support of this position. For example, one scholar simply has suggested that a "forward contract" is not a

---

[24] Casey Doherty, *Bitcoin and Bankruptcy, Understanding the Newest Potential Commodity*, 33-7 ABIJ 38, 38 (July 2014).

[25] *See, e.g.*, Maginnis, *supra* note 22 at 510 n.181.

[26] For a discussion about the meanings of margin payments and settlement payments as used in the Bankruptcy Code, see 5 COLLIER ON BANKRUPTCY ¶ 556.06 (16th ed. 2021).

[27] Illman & Cox, *supra* note 22 at 131; *see* Rayburn *supra* note 22 at 260; Deppert *supra* note 22 at 148; Doherty *supra* note 24 at 38.

typical mechanism by which to transfer cryptocurrency because it requires a gap in the time between delivery of the cryptocurrency and payment therefor.[28]

To the extent that a bankruptcy court finds that cryptocurrency transactions do not fit neatly within one of the Bankruptcy Code's protections from avoidance, understanding the valuation of the cryptocurrency at issue in an avoided transaction becomes a critical matter for a bankruptcy court, and may be influenced by the court's characterization of the cryptocurrency at issue. As set forth above, Bankruptcy Code Section 550 provides for the trustee to recover from the transferee of an avoided transaction (a) the property transferred, or (b) if the court so orders, the value of such property. For example, consider a debtor's prepetition transfer of 10 bitcoins for $100 in cash, and assume post-petition, the value of a single bitcoin at the time the trustee seeks to recover the bitcoins is now $1,000. The remedy of returning the transferred property, 10 bitcoins, may be relatively straightforward; however, the outcome when the transferee no longer has those 10 bitcoins is more challenging.

The Bankruptcy Code does not define "value" or indicate at what time "value" is to be determined.[29] Those advancing the position that cryptocurrency is currency (the transferee in this scenario), have a simple response to this challenge: the recovery can only equal the transfer, and a transfer of $100 leads to a $100 recovery.[30]

Alternatively, those advancing the position that cryptocurrency is a commodity (the trustee in this scenario) respond that the value of the property transferred should be determined at the time of recovery, and, thus, the trustee is entitled to $10,000.[31]

Courts have not reached a clear consensus on the time at which to measure value, and some courts take the view that "the only generally applicable rule in regards to § 550(a) valuation is that 'the time at which the value is measured

---

[28] *See, e.g.*, Illman & Cox, *supra* note 22 at 131.

[29] *See Weinman v. Fid. Capital Appreciation Fund* (*In re Integra Realty Res., Inc.*), 354 F.3d 1246, 1266 (10th Cir. 2004).

[30] *See, e.g.*, Maginnis, *supra* note 22 at 505.

[31] *See, e.g.*, *Brun v. Madray* (*In re Brun*), 360 B.R. 669, 673–75 (Bankr. C.D. Cal. 2007) (explaining that "[a]t least two courts have recognized that the trustee is entitled [under Bankruptcy Code Section 550] to recover the 'greater of the value of the transferred property at the transfer date or the value at the time of the recovery.' [And] [t]his makes sense. . . . [T]his result is consistent with the well-established purpose of § 550, to restore the estate to the position it would have occupied had the property not been transferred." (internal citations omitted)).

depends upon the circumstances of each individual case.' "[32] Given the potential volatility in the market price of cryptocurrencies, such determination may have material implications on recoveries for a debtor's estate.

Imposition of the Automatic Stay and Counterparty Rights

Whether any particular transaction with a cryptocurrency classifies as a swap agreement, a forward contract, or something else, such as a commodity contract, also determines whether the non-debtor counterparty has certain rights under the Bankruptcy Code, including the right to liquidate, terminate, or accelerate that particular agreement or contract.

Bankruptcy Code Section 365(e)(1) prohibits the post-petition termination or modification of an executory contract or unexpired lease because of a provision therein that is conditioned on the insolvency or financial condition of the debtor or the commencement of a bankruptcy case. Section 556, however, overrides Section 365(e)(1)'s prohibition, and allows for the exercise of a contractual right to cause the liquidation, termination, or acceleration of a commodity contract or forward contract because of a debtor's insolvency, financial condition, or commencement of a bankruptcy case.

Similarly, Bankruptcy Code Section 560 overrides Section 365(e)(1)'s prohibition and allows for the exercise of a contractual right to cause the liquidation, termination, or acceleration of a swap agreement because of a debtor's insolvency, financial condition, or commencement of a bankruptcy case.

Moreover, Bankruptcy Code Section 362(b)(6) exempts from the automatic stay the exercise of contractual rights under any forward contract or commodity contract in accordance with Section 556.

Bankruptcy Code Section 362(b)(17) provides a similar exemption from the automatic stay for the exercise of contractual rights under swap agreements in accordance with Section 560.

---

[32] *In re Integra Realty Res., Inc.*, 354 F.3d at 1267 (internal citations omitted); *see, e.g.*, *Decker v. Tramiel* (In re JTS Corp.), 617 F.3d 1102, 1111–12 (9th Cir. 2010) (explaining that "[t]he purpose of § 550 is 'to restore the estate to the financial condition it would have enjoyed if the transfer had not occurred.' The primary goal is equity and restoration, *i.e.*, 'putting the estate back where it would have been but for the transfer.'" (internal citations omitted)); *Feltman v. Warmus* (*In re American Way Serv. Corp.*), 229 B.R. 496, 530–31 (Bankr. S.D. Fla. 1999) (explaining that "the purpose of section 550 is 'to restore the estate to the financial condition it would have enjoyed if the transfer had not occurred.' . . . [Accordingly,] when the property has appreciated [following a fraudulent transfer], the trustee is entitled to recover the property itself, or the value of the property at the time of judgment. . . . [Section 550] is purposefully flexible to accomplish its remedial goal." (internal citations omitted)).

Finally, Bankruptcy Code Section 362(o) offers further protections for the exercise of these contractual rights, providing that such "shall not be stayed by any order of a court."

Therefore, whether a particular cryptocurrency is a currency or a commodity could determine whether a transaction or agreement involving the transfer of that cryptocurrency will receive any protections or rights under the Bankruptcy Code provisions outlined above.

BANKRUPTCY COURTS AND CRYPTOCURRENCY

Bankruptcy courts have yet to make any formative rulings on the application of Section 546's safe harbors or Section 362(b)'s exemptions from the automatic stay to cryptocurrency. However, several cases illuminate the significant impact that such rulings could have on debtors and their creditors and present the parties' different perspectives on how cryptocurrency fits into a bankruptcy case and within the Bankruptcy Code.

Hashfast Technologies LLC and Hashfast LLC

In an adversary proceeding before the U.S. Bankruptcy Court for the Northern District of California (the "California bankruptcy court"), a liquidating trustee sought a determination regarding whether Bitcoin is a commodity or currency.

In August 2013, Hashfast Technologies LLC and Hashfast LLC (together, "Hashfast"), on the one hand, and Mark A. Lowe, on the other hand, entered into a memorandum of understanding (the "MOU")[33] pursuant to which Lowe agreed to endorse Hashfast's products on various online platforms in exchange for 10 percent of the gross proceeds derived from the sale of the first 550 products sold by Hashfast.

Importantly, the MOU provided for Lowe to be paid with cash or bitcoins. Hashfast pre-sold 550 units and despite experiencing severe financial issues, paid Lowe in accordance with the MOU. Due to liquidity constraints, Hashfast elected to pay Lowe in bitcoins and transferred 3,000 bitcoins to Lowe's e-wallet.

On May 9, 2014, when Hashfast failed to fill customers' orders and to service their accounts payable, creditors filed involuntary bankruptcy petitions against Hashfast in the California bankruptcy court. On June 5, 2014, the bankruptcy cases were converted to voluntary cases under Chapter 11.

---

[33] *Kasolas v. Lowe, Adv. Pro.*, No. 15-03011 [Docket Nos. 24, 42, 44, 49] (Bankr. N.D. Cal.).

Thereafter, the trustee appointed to liquidate the debtors' estates (the "Liquidating Trustee") initiated an adversary proceeding against Lowe on behalf of the estates. In the adversary proceeding, the Liquidating Trustee sought partial summary judgment for findings that (a) bitcoins are commodities (not currency), and (b) if transfers of bitcoins are avoided, then the estates would be entitled to either (i) the return of the transferred bitcoins, or (ii) the value of the transferred bitcoins as of the date of recovery. In support of the motion, the Liquidating Trustee relied on determinations by the CFTC and the Internal Revenue Service (the "IRS") that virtual currencies, like Bitcoin, are commodities and property, respectively.[34]

In his response to the Liquidating Trustee's complaint, Lowe argued that the bitcoins he received are currency. In support of this argument, Lowe relied on the Securities and Exchange Commission's ("SEC") position that bitcoins should be considered money and the U.S. Treasury Department's Financial Crimes Enforcement Network's ("FinCEN") guidance calling for virtual currency to be regulated in the same manner as "real" currency.

According to the parties, whether Bitcoin is a commodity or a currency would determine the quantum of value that the Liquidating Trustee could recover under the Bankruptcy Code.

If the court characterized Bitcoin as currency (the value of which typically remains constant over time), the Liquidating Trustee would be entitled to recover only the value that was transferred to Lowe at the date of transfer (or approximately $300,000).

If, however, the court characterized Bitcoin as a commodity, then under U.S. Court of Appeals for the Ninth Circuit law, the court would have discretion to award the Liquidating Trustee the value of the bitcoins measured at the time of recovery (or $1.3 million) in order to place the estates in the same positions they would have been if the transfer had not occurred.[35]

In its summary judgment ruling, the court did not make a determination as to the proper characterization of the bitcoins, concluding that:

> The court does not need to decide whether bitcoin[s] are currency or commodities for purposes of the fraudulent transfer provisions of the bankruptcy code. Rather, it is sufficient to determine that, despite

---

[34] In 2014, the IRS issued a notice stating that for federal tax purposes, virtual currency is "property" and not a currency that could generate foreign currency gain or loss for U.S. federal tax purposes. *See* Notice 2014-12 (2014), https://www.irs.gov/pub/irs-drop/n-14-21.pdf.

[35] *Kasolas v. Lowe, Adv. Pro.*, No. 15-03011 [Docket No. 42] (Bankr. N.D. Cal. Jan. 22, 2016).

defendant's arguments to the contrary, bitcoin are not United States dollars. If and when the Liquidating Trustee prevails and avoids the subject transfer of bitcoin to defendant, the court will decide whether, under 11 U.S.C. § 550(a), he may recover the bitcoin (property) transferred or their value, and if the latter, valued as of what date.[36]

In its decision, the court may be suggesting that Bitcoin is more like a commodity than a currency, but the court did not clarify its ruling or take any different or additional positions on this point in the adversary proceeding. Ultimately, the Liquidating Trustee and Lowe stipulated to a dismissal.

Cred Inc.

Cred Inc. and its affiliates (collectively, "Cred") operated a financial technology platform that allowed customers to transfer cryptocurrencies to Cred through loans or other financing agreements. In turn, Cred used that cryptocurrency in investment strategies involving third-party managers and captured returns on investment for customers.

One of Cred's customers transferred approximately 478 bitcoins to Cred in order to secure a $2 million revolving line of credit.[37] Further, in April 2020, upon fully drawing the line of credit, the customer deposited an additional approximately 531 bitcoins with Cred in order to maintain an agreed loan-to-value ratio under the applicable loan documents. Cred utilized the bitcoins received from the customer in connection with investments through third-party investment managers. Between April 2020 and August 2020, the price of Bitcoin greatly appreciated, and the market value of the bitcoins pledged as collateral increased from approximately $4 million to more than $6.32 million.

Because of the surge in Bitcoin's price, on August 13, 2020, the customer requested to withdraw 10 percent of the bitcoins that it deposited into the collateral accounts (the "Returned Bitcoins") to bring the loan-to-value ratio closer to the agreed-upon level. On August 14, 2020, Cred honored the customer's request and transmitted the Returned Bitcoins to the customer.

A few months later, on November 9, 2020, Cred commenced Chapter 11 cases in the U.S. Bankruptcy Court for the District of Delaware (the "Delaware bankruptcy court").[38] During the bankruptcy cases, the aforementioned

---

[36] *Kasolas v. Lowe, Adv. Pro.*, No. 15-03011 [Docket No. 49] (Bankr. N.D. Cal. Feb. 23, 2016).

[37] *In re Cred. Inc.*, No. 20-12836 [Docket No. 89] (Bankr. D. Del.).

[38] *In re Cred. Inc.*, No. 20-12836 [Docket Nos. 12, 279, 380, 480, 629] (Bankr. D. Del.).

customer filed a motion for relief from the automatic stay (the "Automatic Stay Motion") seeking authority to repay the outstanding revolving loans and recover its collateral (the bitcoins) or the value thereof. In the Automatic Stay Motion, the customer argued that the bitcoins were pledged as collateral and thus, not property of Cred's estates. Therefore, Cred held the bitcoins in trust and was required to return them once the underlying loans were repaid.

In opposition to the Automatic Stay Motion, Cred made two main arguments.

First, the customer did not pledge its bitcoins to Cred but instead, transferred its interests in the bitcoins to Cred in exchange for a revolving line of credit and the right to receive an equivalent amount of bitcoins once the revolving line of credit was repaid in full. In support of this position, Cred argued that the specific bitcoins transferred to Cred by the customer were fungible and could not be traced once commingled with other bitcoins in Cred's e-wallet.

Second, Cred argued that the customer was the recipient of a preferential transfer and, pursuant to Bankruptcy Code Section 502(d), was not entitled to any relief until the preferential transfer was returned. Specifically, Cred alleged that the customer had received a preferential transfer when Cred transferred the Returned Bitcoins to the customer on August 14, 2020 (87 days prior to the petition date) on account of an alleged antecedent debt.

Cred's Section 502(d) argument against the Automatic Stay Motion presented the Delaware bankruptcy court with an opportunity to apply the Bankruptcy Code's provisions to the transfer of cryptocurrency and potentially (a) classify bitcoins as a currency, commodity, or something else in order to determine the applicability of the safe harbors in Section 546 discussed above, and/or (b) determine how to value cryptocurrency and at what time.[39]

The Delaware bankruptcy court, however, did not rule on this issue. Instead, the court explained that because Cred had transferred the bitcoins to

---

[39] Interestingly, throughout the bankruptcy cases, the debtors likened Bitcoin to a traditional currency—a position that could have hampered their efforts to avoid the transfer of bitcoins and led to a lesser recovery of any avoided transfer. For example, in a declaration by one of Cred's financial advisory professionals, the declarant described cryptocurrency as "an alternative to fiat currency" that uses encryption technology to "control the creation of monetary units[.]" Decl. of Drew McManigle, Founder and Chief Executive Officer, MACCO Restructuring Group, LLC, ¶ 14 [Docket No. 16] (Bankr. D. Del. Nov. 9, 2020). As explained above, if bitcoins are classified as currency, then a transaction involving bitcoins may be more likely to fall within Section 546's safe harbor from avoidance for swap agreements. Moreover, even if the particular transfer did not qualify for a safe harbor from avoidance and is ultimately avoided, then the value of the bitcoins transferred may be measured as of the date of transfer and any post-petition increase in value may not be captured and returned.

non-debtor investment managers prior to the petition date, the automatic stay did not preclude the customer from commencing an action against those non-debtor third parties for damages relating to the disposition of its bitcoins. Having determined that the relief requested in the Automatic Stay Motion was unnecessary, the Delaware bankruptcy court denied the motion.

MtGox Co., Ltd.

On February 28, 2014, MtGox Co., Ltd. ("MtGox") filed a petition for the commencement of a civil rehabilitation proceeding (a proceeding contemplating the restructuring of a company) under Japanese law in Tokyo. MtGox operated an online Bitcoin exchange but lost nearly 750,000 of its customers' bitcoins and about 100,000 of its own bitcoins when, according to MtGox, its systems were hacked. The bitcoins that were lost, in the aggregate, accounted for about seven percent of all bitcoins in the world at that time. MtGox, through its foreign representative, also commenced a bankruptcy case under Chapter 15 of the Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of Texas (the "Texas bankruptcy court").

On April 24, 2014, the Japanese court entered orders dismissing the restructuring proceeding, commencing a liquidation proceeding (the "Japan Liquidation Proceeding"), and appointing a bankruptcy trustee. For the Japan Liquidation Proceeding, MtGox was required to value creditors' bitcoin-related claims as of the commencement of such proceeding, with any surplus value in the estate (as a result of an increase in the value of the remaining bitcoins held by MtGox) returning to shareholders.

On November 24, 2017, a creditor holding a bitcoin-related claim petitioned for the commencement of another restructuring proceeding (the "Second Civil Rehabilitation Proceeding") in order for creditors—instead of shareholders—to capture the increase in value of the bitcoins from April 2014 to November 2017. On April 24, 2014, the market price of one bitcoin was $438. By November 24, 2017, that number had climbed to $8,201.46. The Japanese law applicable to a rehabilitation proceeding provided MtGox with more flexibility to determine the time at which to value bitcoin-based claims and the ability to distribute bitcoins to creditors. On June 22, 2018, the Japanese court commenced the Second Civil Rehabilitation Proceeding, which remains ongoing.[40] In the seven years after first commencing a restructuring proceeding, MtGox, and its creditors still do not have finality, but during that same time, the market price for their bitcoins has increased more than 18-fold, and the creditors may be able to recover that upside.

---

[40] *See In re MtGox Co., Ltd.*, No. 14-31229 [Docket No. 201] (Bankr. N.D. Tex.); *Greene v. Karpeles*, No. 14-01437 [Docket No. 529-1] (N.D. Ill. Dec. 21, 2020).

As of the date of this article, the Chapter 15 case has not presented an opportunity for the Texas bankruptcy court to weigh in on the valuation or classification of cryptocurrency. That being said, the case presents an interesting example of how the fluctuation in the market price of a cryptocurrency can give rise to material disputes between stakeholders.

NON-BANKRUPTCY COURTS WEIGHING IN ON THE CLASSIFICATION OF CRYPTOCURRENCY

This section summarizes prominent non-bankruptcy court rulings on the appropriate classification of particular cryptocurrencies.

In 2014, the U.S. District Court for the Southern District of New York seemingly gave support for the classification of Bitcoin as both a currency *and* a commodity.

In *United States v. Ulbricht,* a grand jury returned an indictment charging Ross Ulbricht on four counts, including, a money laundering conspiracy.[41] The charges stemmed from Ulbricht's "designing, launching, and administering of a website called Silk Road as an online marketplace for illicit goods and services."[42] In this marketplace, the exclusive form of payment was Bitcoin. Ulbricht moved to dismiss all counts, arguing, among other things, that payment by Bitcoin did not qualify as a "financial transaction" for purposes of the applicable money laundering conspiracy statute.

The court disagreed. The money laundering statute defines a "financial transaction" as involving "the movement of funds by wire or other means," or "involving one or more monetary instruments."[43] The statute does not define "funds" or "money," so the court defined "funds" according to its ordinary meaning as "money, often money for a specific purpose" and "money" as "an object used to buy things."[44]

From there, the court concluded that "[t]he money laundering statute is broad enough to encompass use of Bitcoins in financial transactions. Any other reading would—in light of Bitcoins' sole raison d'etre [the only value for Bitcoin lies in its ability to pay for things]—be nonsensical.[45]

Then, the court used a commodity—gold—as a metaphor for Bitcoin: "[t]here is no doubt that if a narcotics transaction was paid for in cash, which

---

[41] *See United States v. Ulbricht*, 31 F. Supp. 3d 540 (S.D.N.Y. 2019).

[42] *Id.* at 546–47.

[43] 11. U.S.C. § 1956(c)(4).

[44] *Ulbricht*, 31 F. Supp. 3d at 570.

[45] *Id.*

was later exchanged for gold, and then converted back to cash, that would constitute a money laundering transaction."[46]

Several years later, in March 2018, in *CFTC v. McDonnell*, the U.S. District Court for the Eastern District of New York considered whether "virtual currency may be regulated by the CFTC as a commodity."[47] The court answered this question in the affirmative. The Commodity Exchange Act (the "CEA") defines "commodity" as "all other goods and articles . . . and all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in."[48] Based on this definition, the court found that "commodity" under the CEA covered virtual currency. The court also noted the CFTC's history of classifying virtual currencies as commodities.

In September 2018, the U.S. District Court for the District of Massachusetts ruled similarly that a less popular cryptocurrency was a commodity. In *CFTC v. My Big Coin Pay, Inc.*, the court—like the *McDonnell* court—examined the definition of "commodity" to determine whether virtual currency fell within the CFTC's regulatory purview.[49]

The court interpreted the CEA as defining "commodity" by focusing on categories (instead of specific items) in which "contracts for future delivery are presently or in the future dealt in."[50] The court acknowledged that "contracts for future delivery" are not "dealt in" the particular type of virtual currency at issue—My Big Coin—but found the existence of futures trading in virtual currencies (like Bitcoin) sufficient at this stage of the litigation to include My Big Coin within the definition of "commodity" under the CEA.

U.S. AGENCIES' POSITIONS ON CRYPTOCURRENCY

The CFTC's position that virtual currencies (like Bitcoin and My Big Coin) are commodities reveals an interesting trend with respect to government agencies' classification of cryptocurrencies. Agencies are classifying cryptocurrency in a way that allows them to exercise authority over and regulate the particular cryptocurrency at issue, without necessarily taking into account the nuances of any particular cryptocurrency.[51] A former CFTC chair framed this

---

[46] *Id.*

[47] *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 217 (E.D.N.Y. 2018).

[48] 7 U.S.C. § 1a(9).

[49] *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492 (D. Mass. 2018).

[50] 7 U.S.C. § 1a(9).

[51] *See also* Ryan W. Bell, *Cryptocurrency in the Law: An Analysis of the Treatment of*

concept as a commitment to "aggressively prosecute bad actors."[52] Regardless of the motivations behind any particular agency's classification of a cryptocurrency, those agencies' positions may carry weight with other adjudicators (including bankruptcy courts) in the future.

In addition to the CFTC, the SEC has weighed in on the classification of cryptocurrencies. In February 2018, the then-chair of the SEC testified about cryptocurrencies before a Senate committee.[53] His testimony presented the view that cryptocurrencies can be securities, and if a cryptocurrency, or a product with its value tied to one or more cryptocurrencies, is a security, then promoters cannot make offers or sales unless they comply with the applicable requirements under federal securities laws.

The chair's testimony was focused on initial coin offerings ("ICOs"), which had gained notoriety at the time.[54] ICOs generally involve a specific period during which a company sells a predetermined number of tokens to the public usually in exchange for major cryptocurrencies or against fiat currencies.[55] The chair underscored that "by and large, the structures of ICOs that I have seen involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws."[56]

Cryptocurrency in Bankruptcy, 35 Cal. Bankr. J. 43, 7; (2019); Megan McDermott, *The Crypto Quandary: Is Bankruptcy Ready?*, 115 N.w. U. L. Rev. Online 24, 56–57 (2020).

[52] Written Testimony of Chairman J. Christopher Giancarlo before the Senate Banking Committee (Feb. 6, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo37.

[53] Chairman's Testimony on Virtual Currencies: The Roles of the SEC and CFTC (Feb. 6, 2018), https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission.

[54] On October 11, 2019, the SEC filed a complaint against Telegram Group Inc. and its wholly owned subsidiary, TON Issuer Inc. (together, the "Defendants"). *See SEC v. Telegram Group Inc.*, No. 19-9439 [Docket No. 1] (S.D.N.Y.). The complaint alleged that the Defendants conducted an illegal offering of digital-asset securities—Grams—beginning in January 2018. On June 29, 2020, the SEC announced a settlement with the Defendants, pursuant to which the Defendants would not admit or deny the allegations in the SEC's complaint but would disgorge more than $1.2 billion in gains from the sale of Grams and pay an $18.5 million civil penalty. *See Telegram to Return $1.2 Billion to Investors and Pay $18.5 Million Penalty to Settle SEC Charges*, SEC, https://www.sec.gov/news/press-release/2020-146.

[55] *Initial Coin Offerings*, PWC (June 2018) at 2, https://www.pwc.ch/en/publications/2018/20180628_PwC%20S&%20CVA%20ICO%20Report_EN.pdf.

[56] Chairman's Testimony on Virtual Currencies: The Roles of the SEC and CFTC (Feb. 6, 2018), https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission.

Around the same time, in *SEC v. AriseBank*, the SEC, for the first time, moved for the appointment of a receiver in an enforcement action against the promoters of an ICO.[57]

In that case, the SEC alleged that two individuals, together through AriseBank, were raising money through an illegal securities offering of AriseCoin—AriseBank's cryptocurrency—through an ICO. The SEC alleged that the individual defendants and AriseBank were publicly marketing securities using internet websites, certain offering documents, press releases, social media accounts, and chat services but did not register the securities with the SEC or file any forms claiming an exemption from registration.

Moreover, these marketing efforts allegedly included material misstatements and omissions. For example, the individual defendants claimed that AriseBank agreed to purchase a bank insured by the Federal Deposit Insurance Corporation ("FDIC"), and as a result, Arise had the full financial capabilities of a traditional bank. The FDIC, however, confirmed that AriseBank was not insured and the bank AriseBank allegedly purchased was not registered with the FDIC.

The SEC sought emergency relief, requesting the immediate appointment of a receiver over AriseBank. The U.S. District Court for the Northern District of Texas entered an order appointing a receiver on the same day the case was filed. The court charged the receiver with marshaling and preserving all assets, tangible and intangible, owned, controlled, or possessed by AriseBank. The court entered a final judgment in December 2018, which (a) permanently restrained and enjoined the individual defendants from (i) violating securities laws, and (ii) participating in the issuance, offer, or sale or any digital security (with certain limited exceptions), and (b) provided for the disgorgement of the individual defendants' profits from the ICO—more than $2.2 million.

While the SEC and the CFTC have been the most active agencies in the cryptocurrency space relevant to the discussions here, other agencies have taken positions with respect to the categorical classification of virtual currencies.

Both FinCEN and the Department of Justice have placed "virtual currencies" within the class of currency but note that virtual currencies are different from traditional currencies. FinCEN regulations define currency (or "real" currency) as "the coin and paper money of the United States or of any other country that is [i] designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance."[58]

---

[57] *SEC v. AriseBank*, No. 18-00186 [Docket Nos. 2,6 7, 12, 96] (N.D. Tex.).

[58] Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using

In contrast, FinCEN advised that "virtual" currency is "a medium or exchange that operates like a currency in some environments, but does not have all the attributes of real currency."[59]

Similarly, the Department of Justice published a "Cryptocurrency Enforcement Framework" that defines virtual currency by comparing it to, and distinguishing it from, traditional currency. The DOJ recognized that both virtual currency and traditional currency function as a "medium of exchange" but focused on one obvious difference: "virtual currency does not have legal tender status in any particular country or for any government or other creditor. Instead, the exchange value of a particular virtual currency generally is based on agreement or trust among its community of users."[60]

CONCLUSION

Clearly, no uniform classification scheme or regulatory framework for cryptocurrency exists, let alone a scheme or framework that recognizes the nuances among cryptocurrencies. As noted above, the ultimate characterization of cryptocurrencies can have material impacts on the treatment of certain prepetition transactions and valuation issues in bankruptcy cases.

In the absence of guidance from bankruptcy courts on these issues, however, a significant amount of uncertainty will hover over any company that transacts in or holds cryptocurrencies and becomes a debtor or creditor in a Chapter 11 case.

In light of cryptocurrencies' increasing popularity and prevalence, it will not be long before bankruptcy courts are required to rule on issues pertaining to cryptocurrencies, which may lead to some of the most interesting and complex restructurings yet.

Virtual Currencies (Mar. 18, 2013), https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf.

[59] *Id.*

[60] Report of the Attorney General's Cyber Digital Task Force, Cryptocurrency Enforcement Framework (Oct. 2020), https://www.justice.gov/archives/ag/page/file/1326061/download.