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BITCOIN WHEN THE BANK BREAKS:
UNCERTAINTY IN THE TREATMENT OF
BITCOIN & OTHER CRYPTOCURRENCIES
IN THE FACE OF BANKRUPTCY

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INTRODUCTION

Bitcoin has gone from existing as a little-known innovation tucked into a niche corner of the Web to becoming a globally-recognized buzzword in record time. Along with this newfound popularity, Bitcoin has invited much speculation as

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to the future utility of cryptocurrencies generally, as well as their underlying blockchain technology. Whether one believes this technology will transform society's operational landscape—similar to that of the Internet's revolutionary effect—or takes the pessimistic position that cryptocurrency is nothing more than a tulip bubble of the contemporary age, one fact is undeniable: cryptocurrencies are now intertwined with the American economy.

A 2017 study found that 11% of Americans reported either currently owning or having previously owned Bitcoin, while 17% of respondents claimed they planned to invest in Bitcoin “as an asset for the future.”¹ Perhaps this explains why over 100,000 merchants have begun accepting cryptocurrencies as a legitimate form of payment.² And although this may appear to be an insignificant fraction of the market when considered globally, with big economic players like Subway, Expedia, and Whole Foods signing on to the cryptocurrency craze, it is very likely that many others will follow suit.³ On top of this, the rise of ransomware attacks which can have paralyzing effects on big corporations has led thousands of U.S. companies to hold quantities of digital currencies as a defensive strategy in order to resolve such potential attacks as quickly as possible.⁴

Yet, despite the fact that more and more entities continue to hold cryptocurrencies as an asset, and the strong likelihood of their continued pervasiveness in the American market, astonishingly little attention has been paid to the treatment of Bitcoin and other cryptocurrencies in the event of bankruptcy. Bankruptcy courts' failure to offer guidance on the appropriate classification of cryptocurrencies under the Bankruptcy Code has resulted in increased uncertainty in what is already a

1. Andrew Helman & Carl N. Wedoff, *When Blockchain Meets Article 9 and Bankruptcy*, LAW360 (Feb. 9, 2018), <https://www.law360.com/articles/1011153/when-blockchain-meets-article-9-and-bankruptcy>; Mike Brown, *Bitcoin's Present (and Future) Role in the American Economy*, LENDEDU (Sept. 9, 2017), <https://lendedu.com/blog/bitcoins-role-in-the-american-economy/>.

2. Helman & Wedoff, *supra* note 1.

3. Erin J. Illman & Robert A. Cox, *Bitcoin and Bankruptcy: Why Creditors and Bankruptcy Practitioners Need to Understand Cryptocurrencies*, WESTLAW J. BANKR. (Dec. 14, 2017), https://www.bradley.com/-/media/files/insights/publications/2017/12/westlaw_journal_bankruptcy_december14.pdf.

4. *Id.*

turbulent time for creditors of an insolvent entity. While certain assets such as currency are afforded a number of protections in bankruptcy proceedings, other assets are not. The repercussions from this lack of action by the bankruptcy courts have also echoed outside the bankruptcy realm, as parties face difficulty in contracting around an asset that fundamentally lacks clarity in the event of the deal going bad. Additionally, the unprecedented volatility of this new asset makes valuation difficult when distributing interests to creditors. Whether the bankruptcy court chooses to make its own determination as to the status of cryptocurrencies or chooses instead to rely on a framework laid out by others, one thing remains certain—swift action must be taken.

I.

BITCOIN IN BANKRUPTCY

Bankruptcy is a code-based law, which means that Congress has codified the wide breadth of this area of law through legislation. Bankruptcy is offered as a “fresh start” to an entity that has found itself underwater. The code, therefore, attempts to balance the interests of the insolvent entity’s survival with the interests of the creditors who have outstanding financial claims against the entity. This has resulted in a code that provides certain protections to both the debtor (the insolvent entity) and the creditors. However, the uncertainty of cryptocurrencies’ status under the code creates ambiguity as to which protections these assets are afforded.

When a party files a petition for bankruptcy, § 541 of the Bankruptcy Code outlines what property is to be included in the “bankruptcy estate”—the pooled interests of the debtor that will be used to satisfy fractions of the creditors’ claims. Section 541 broadly defines the bankruptcy estate as encompassing “all legal or equitable interests of the debtor in property as of the commencement of the case.”⁵ Therefore, it is uncontroversial to conclude that cryptocurrency assets are included within the bankruptcy estate.⁶

5. 11 U.S.C. § 541(a)(1) (2012); *Bankruptcy Basics Glossary*, U.S. COURTS, <https://www.uscourts.gov/educational-resources/educational-activities/bankruptcy-basics-glossary#content-for-b> (last visited Sept. 30, 2019).

6. Chelsea Deppert, *Bitcoin and Bankruptcy: Putting the Bits Together*, 32 EMORY BANKR. DEV. J. 123, 130 (2015).

Unfortunately, this is where the consensus ends, as there is currently no agreement on how to classify Bitcoin and other cryptocurrencies as they appear within the bankruptcy estate. The lack of consensus is no small concern. Whether this type of asset is considered a *currency* or a *commodity* will have drastically different consequences on the outcome. For example, when a trustee is appointed to oversee the bankruptcy estate on behalf of the debtor, § 548 of the Bankruptcy Code gives the trustee (or the debtor-in-possession, if permitted) the power of avoidance.⁷ Avoidance grants the trustee the ability to recover certain transfers made by the debtor within the past two years, beginning on the date of the bankruptcy petition's filing with the court.⁸ Avoidance allows past transactions to be reversed if the transfer is considered "constructively fraudulent"—meaning that the debtor did not receive a reasonably equivalent value in the transfer, and was either insolvent at the time of the transfer or became insolvent as a result of the transfer.⁹ However, the Code affords certain immunities to transactions involving different currencies, called "swap agreements," which includes protection against avoidance.¹⁰ These protections are not automatically granted to transactions involving commodities.

To illustrate this point, suppose Corporation A sells 100 bitcoins to Corporation B for \$500,000 USD. Corporation A files for bankruptcy a month later. At the time of the transfer, one bitcoin was worth \$6,000 USD on the open market, but Corporation A was willing to take less in order to get its hands on quick cash in a hushed manner. Corporation A clearly did not receive a "reasonably equivalent" value as contemplated by § 546. Despite this fact, if the bankruptcy court considered the bitcoins as a currency, this transaction would be protected from reversal; and conversely, if the court ruled that the bitcoins are a commodity, the transaction would most likely be reversed. As reversal would increase the value of the bankruptcy estate by \$100,000—and thereby increase creditors' chances of being made whole—the gravity of Bitcoin's classifi-

7. 11 U.S.C. § 548 (2012).

8. *Id.*

9. Deppert, *supra* note 6, at 147; *see also* 11 U.S.C. § 548(a)(1)(B) (2012).

10. 11 U.S.C. § 546(g) (2012); Deppert, *supra* note 6, at 147.

cation pertaining to bankruptcy proceedings cannot be overstated.

A. *Blunders of the Bankruptcy Courts*

To date, bankruptcy courts have had limited exposure to litigating cryptocurrencies, but in the few matters where the opportunity to classify the asset has presented itself the courts have responded “no thank you.”

In the case of *CLI Holdings*, the debtor was a Bitcoin mining company that consisted entirely of the hardware used in the Bitcoin mining process. The debtor received \$75,000 in financing from Bitvestment LLC in exchange for the first 7,984 bitcoins mined by the debtor.¹¹ This arrangement is similar to the “overriding royalty interest” agreements popular in the industries of subterranean commodities such as oil and gas, in which loans would be exchanged for the right to portions of the extracted product.¹² As the price of Bitcoin continued to rise, the debtor ceased all payments citing crippling costs. Bitvestment sued and the debtor subsequently filed for Chapter 11 bankruptcy, which immediately stayed the litigation.¹³ In the bankruptcy proceedings, the debtor sought to have the Bitvestment contract rejected—a type of bankruptcy relief granted where the contract is no longer profitable for the debtor—arguing that the financial return on mining was trending downwards.¹⁴ At the time the bankruptcy petition was filed, 7,984 bitcoins were worth \$1,644,704, and during the course of the proceedings the value grew to \$8,910,144.¹⁵ The debtor would clearly be better off if it were given the opportunity to restructure its agreement with Bitvestment to more favorable terms. A rejection of the contract would also allow the debtor to sell the hardware, which was otherwise locked into the contract because of the necessary role it plays in producing the bitcoins owed. Ultimately, the court held that the contract did not qualify for rejection because it was not “executory,” due to the fact that the only performance required by

11. See Deppert, *supra* note 6, at 134 (citations omitted).

12. Casey Doherty, *Bitcoin and Bankruptcy: Understanding the Newest Potential Commodity*, 33-7 AM. BANKR. INST. J. 38, 39 (2014) (citations omitted).

13. *Id.*

14. *Id.*

15. *Id.*

Bitvestment was to receive the produced bitcoins.¹⁶ The court treated bitcoins the same way it would treat any other commodities that are subject to an overriding royalty interest.¹⁷ Although this holding was entirely consistent with precedent in similar agreements in the oil and gas industries—two areas of business which unquestionably deal in commodities—the court chose not to go the final step of equating cryptocurrencies to commodities or opine in any way on Bitcoin’s status as an asset.¹⁸

The topic of Bitcoin classification arose in another bankruptcy court, this time in the Northern District of California in *Hashfast Technologies*.¹⁹ The debtor in this case made a pre-petition transfer of 3,000 bitcoins to a party related to the company. The bankruptcy trustee found the transfer to be suspicious and sought avoidance, arguing that the asset transfer equated to fraud.²⁰ Because this was a transfer alleged to be actually fraudulent, as opposed to “constructively fraudulent” (discussed *supra*), the transfer could be avoided regardless of Bitcoin’s classification so long as the trustee could prove fraud. However, the classification played a vital role in determining how to value the asset—at the time of transferal, the bitcoins were collectively worth \$363,861.43, but on the date of the bankruptcy filing the value had increased to around \$1.3 million.²¹ The trustee argued in its motion that because Bitcoin is a commodity, the bankruptcy estate should either receive the returned bitcoins in full or receive the equivalent of their increased value of \$1.3 million.²² The trustee’s reasoning relied on § 550 of the Bankruptcy Code, which states that in the event of a fraudulent transfer the bankruptcy estate is entitled to the “property transferred, or, if the court so orders, the value of such property.”²³ The defendant-transferee asserted

16. *Id.*

17. Deppert, *supra* note 6, at 134.

18. *Id.*; see also *In re CLI Holdings*, Case No. 13-19746 (W.D. Wash. 2013).

19. Erin Illman & Robert Cox, *Bitcoin: A New, Volatile Asset in Bankruptcy*, LAW360 (March 13, 2018), <https://www.law360.com/articles/1021276/bitcoin-a-new-volatile-asset-in-bankruptcy>.

20. Illman & Cox, *supra* note 3; see also Mary E. Maginnis, *Money for Nothing: The Treatment of Bitcoin in Section 550 Recovery Actions*, U. PA. J. BUS. L. 485, 486 (2018).

21. Illman & Cox, *supra* note 19.

22. *Id.*

23. 11 U.S.C. § 550(a) (2012).

that Bitcoin is not a commodity, but instead a form of currency, and so the value owed to the bankruptcy estate, if the court found the transfer to be fraudulent, was \$363,861.83—the cash value of the bitcoins at the time of the transfer.²⁴

Although this was a prime opportunity for the bankruptcy court to offer much-needed clarification on the matter, it decided to skirt the issue on all fronts. The court held narrowly that “bitcoin are not United States dollars”—leaving wide open the question of whether cryptocurrencies are a form of currency or commodity under the Code.²⁵ As to the proper method of valuation, the court chose to punt the million-dollar question to its future self, holding that it will wait to decide the proper date with which to value the bitcoin until the trustee prevails on its fraud claim. The parties settled before this happened, so the court was freed from ever making a final determination.²⁶

The courts’ reluctance thus far to rule on the issue has created unnecessary uncertainty for both debtors and creditors in the realm of bankruptcy. As the American economy’s welcoming of cryptocurrencies as a legitimate form of payment and investment tool continues to increase, so too does the likelihood of bankrupt entities possessing portfolios of cryptocurrencies. Bankruptcy courts can only deflect for so long.

II.

A CLASSIFICATION CATASTROPHE: CURRENCY OR COMMODITY

With little assistance from the bankruptcy courts on how to interpret Bitcoin and other cryptocurrencies, parties attempting to assess their potential risk in the event of bankruptcy are left looking to other regulatory authorities for guidance. Yet, those conclusions have resulted in anything but a consensus.

One such authority is the Uniform Commercial Code (“UCC”), which has been universally adopted by all 50 U.S. states. The UCC defines *money* as: “a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account estab-

24. Illman & Cox, *supra* note 19.

25. *Id.*

26. *Id.*

lished by an intergovernmental organization or by agreement between two or more countries.”²⁷ The most crucial takeaway is the UCC’s minimum requirement that an asset be authorized or adopted by a government to be considered “money.” This definition, coupled with the fact that Bitcoin has not currently been adopted by any government as an official currency, would appear to conclude that Bitcoin is not a currency under the law. However, federal court interpretations have painted a less clear picture.

In *SEC v. Shavers*, the Security Exchange Commission (“SEC”) brought a federal action against Shavers for defrauding investors in what was a bitcoin-for-bitcoin Ponzi scheme. Shavers challenged the SEC’s jurisdiction, arguing that because Bitcoin is not a form of money or currency recognized by the government the scheme fell outside the domain of the securities laws.²⁸ In order for Shaver’s investment scheme to qualify as a security (or investment contract), and therefore fall within its jurisdiction, the SEC would need to prove that it satisfies the three factors of the Supreme Court’s *Howey* test—one of which is a showing that Shaver’s investment device constituted an “investment of *money*” (emphasis added).²⁹ In its final determination, the Texas federal district court found that the bitcoin investment device satisfied this factor because bitcoins “can be used as money. . . to purchase goods and services.”³⁰ Therefore, the court held, “Bitcoin is a currency or form of money” and the SEC was operating within its jurisdiction.³¹

Unlike the UCC, the court did not appear concerned with the idea that to qualify as money, an asset has to be authorized or adopted by a government. Instead, the court reasoned that Bitcoin’s ability to be “exchanged for conventional currencies, such as the U.S. dollar, Euro, Yen, and Yuan”—all of which are either government-backed or backed by an intergovernmental

27. U.C.C. § 1-201(b)(24) (AM. LAW INST. & UNIF. LAW COMM’N 1977).

28. Dan Stroh, *Secure Currency or Security? The SEC and Bitcoin Regulation*, U. CIN. L. REV. BLOG (Nov. 18, 2014), <http://uclawreview.org/2014/11/18/secure-currency-or-security-the-sec-and-bitcoin-regulation/> [http://perma.cc/2MZM-SPCG].

29. *Id.*; *SEC v. W.J. Howey & Co.*, 328 U.S. 293, 298–99 (1946).

30. *SEC v. Shavers*, No. 4:13-CV-416, 2013 U.S. Dist. LEXIS 110018, at *4 (E.D. Tex. Aug. 6, 2013); *see also* Deppert, *supra* note 6, at 135.

31. *Shavers*, 2013 U.S. Dist. LEXIS 110018, at *5.

body—was sufficient to consider it as a form of money.³² Others were not so quick to agree. The court’s decision was so controversial within the state that it led to the Texas Department of Banking publishing a Supervisory Memorandum stating that cryptocurrency is not money or currency under the Texas Money Services Act.³³ Although the memo was matter-of-fact in its declaration, it also disclaimed that this memo was to serve only as guidance under the current definitions within the statute, leaving the door open for future regulatory change in this area of the law.³⁴

Upon the memo’s publishing, Shavers again tried to dismiss the SEC’s complaint, this time citing the Texas Department of Banking’s own words attesting to Bitcoin’s status as a non-money good. By this point, others had also argued that the court’s original decision in *Shavers* was too heavily influenced by public policy concerns on consumer protection and did not properly consider the wider implications that would result from equating Bitcoin to money.³⁵ However, the court rejected its second chance and denied the motion, reasoning that the memo’s definition was only applicable to Texas’s current laws on virtual currencies.³⁶

If that did not create enough uncertainty on the matter, a Massachusetts district court took a different approach in its interpretation of virtual currencies in a 2018 case. In *U.S. Commodity Futures Trading Commission v. My Big Coin Pay Inc.*, the Commodity Futures Trading Commission (“CFTC”) filed a complaint against My Big Coin Pay Inc. alleging that it was operating a fraudulent virtual currency scheme in violation of the Commodities Exchange Act (“CEA”).³⁷ The CFTC complaint alleged that the defendants made untrue and mislead-

32. *Id.*

33. Tex. Dep’t of Banking Laws & Regulations, Memorandum on Regulatory Treatment of Virtual Currencies Under the Texas Money Securities Act to All Virtual Currency Companies Operating or Desiring to Operate in Texas, at 3 (Apr. 3, 2014), <https://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf>; see also Deppert, *supra* note 6, at 135–36.

34. Deppert, *supra* note 6, at 136.

35. *Id.*

36. *Id.*; see also Miriam Rozen, *Bitcoin: Daylight Between Definitions Used by Federal Court and State Agency?*, TEX. LAWYER (Sept. 29, 2014).

37. Joanne Lee Molinaro & Susan Poll Klaessy, *Crypto as Commodity, and the Bankruptcy Applications*, LAW360 (Oct. 17, 2018), ¶ 8, <https://www.law360>

ing statements, such as claiming the virtual currency was “backed by gold” in order to entice customers to purchase the asset.³⁸ In a reverse-*Shavers* situation, the defendants moved to dismiss the complaint claiming that virtual currencies were not commodities under the CEA, and therefore were outside of the CFTC’s jurisdiction.³⁹ In its argument that virtual currencies are commodities, the CFTC pointed to § 1a(9) of the CEA, which defines commodity as including all goods and interests in which “contracts for future delivery” are dealt in.⁴⁰ Because some virtual currencies partake in futures trading in the same way that many other known commodities do, the CFTC opined, the virtual currency at issue here is a commodity under the statute’s definition.⁴¹ The defendant responded that because the specific virtual currency in this case did not “deal” in “contracts for future delivery,” it cannot be a commodity under the CEA.⁴² Due to the limited case law contemplating the status of virtual currencies, the court looked to the precedent of a well-known commodity for comparison—natural gas. The court reasoned that similar to how futures contracts in some brands of natural gas render all specific types of natural gas as commodities, futures trading in some cryptocurrencies—namely Bitcoin—renders all types of virtual currencies as commodities under the CEA.⁴³

Although this appears to be the most recent interpretation by the federal courts on this controversial matter, it is completely at odds with the holding in *Shavers*, as well as the Southern District’s strong language in the infamous Silk Road opinion.⁴⁴ In that 2014 case, the district court held that Bitcoin constituted a “monetary instrument” as it was contemplated by the money laundering statute, and reasoned that

.com/articles/1093091/crypto-as-commodity-and-the-bankruptcy-implications.

38. CFTC v. My Big Coin Pay, Inc., 334 F. Supp. 3d 492, 494 (D. Mass. 2018).

39. *Id.* at 495.

40. 7 U.S.C. § 1a(9); *see also* My Big Coin Pay, 334 F. Supp. 3d at 496.

41. My Big Coin Pay, 334 F. Supp. 3d at 496.

42. *Id.*

43. My Big Coin Pay, 334 F. Supp. 3d at 497–98; Molinaro & Klaessy, *supra* note 37, ¶ 11; *see also* CFTC v. McDonnell, No. 18-CV-361, 2018 U.S. Dist. LEXIS 146576 (E.D.N.Y. Aug. 23, 2018) (holding that virtual currencies are a commodity within CEA and may be regulated by the CFTC).

44. *See* United States v. Ulbricht, 31 F. Supp. 3d 540 (S.D.N.Y. 2014).

“any other reading would—in light of Bitcoins’ *sole raison d’être* [sole reason for existence]—be nonsensical.”⁴⁵

Other governmental bodies have also thrown their hats in the classification ring. The Internal Revenue Service (“IRS”) released a guidance in 2014 advising the public that bitcoins are considered *property* for tax purposes and that “[g]eneral tax principles applicable to property transactions apply to transactions using virtual currency.”⁴⁶ That same year, the Eleventh Judicial Circuit in Miami-Dade County held that Bitcoin was not a currency and that at the time of the court’s ruling, “attempting to fit the sale of Bitcoin into a statutory scheme regulating money services businesses [is] like fitting a square peg in a round hole.”⁴⁷ And as recently as March 2019, states such as Wyoming have enacted legislation giving virtual currencies the same treatment as money within the state.⁴⁸

The result of this frenzy of conflicting interpretations is utter chaos for any party who seeks to accurately understand their liabilities when dealing and contracting in cryptocurrency assets.

III.

EFFECTS ON BANKRUPTCY

While the ambiguity of cryptocurrency’s status as an asset has troubling consequences in many areas of law and business, the repercussions are particularly significant in the bankruptcy context. As the Bankruptcy Code offers certain protections to some asset classifications while specifically excluding others, this lack of clarity leaves both debtors and creditors even more uncertain about their exposure in a situation that is already inherently tumultuous. Additionally, cryptocurrency’s unique volatility, coupled with the differing sell-off timelines among bankruptcy chapters, has the potential to create catastrophic

45. *Id.* at 570.

46. See I.R.S. Notice 2014-21, www.irs.gov/pub/irs-drop/n-14-21.pdf.

47. *State v. Espinoza*, No. F14-2923 (Fl. Cir. Ct. July 22, 2016) (Order Granting Defendant’s Motion to Dismiss the Information); see also Alan Rosenberg, *Feature, The Cryptocurrency Craze: How to Treat Bitcoins in Fraudulent Transfer Litigation*, 39-2 AM. BANKR. INST. J. 36, 37 (2018).

48. Darryn Pollock, *Wyoming Introduces Bill Offering Cryptocurrencies Legal Clarity to Attract Blockchain Business*, FORBES, (Jan. 19, 2019), <https://www.forbes.com/sites/darrynpollock/2019/01/18/wyoming-introduces-bill-offering-cryptocurrencies-legal-clarity-to-attract-blockchain-business/>.

(yet, unnecessary) lose-lose situations for both debtors and creditors. Issues over ownership may also arise if a custodian of the underlying assets of a stablecoin—a cryptocurrency backed by a particular asset—becomes insolvent. And if all of that were not enough to complicate matters, cryptocurrency’s classification under the UCC has the potential to lead to unexpected security interests that attach to the asset, and which could ultimately inhibit a creditor’s bankruptcy recovery.

Although innovation and technological advancement are exciting prospects, they are inevitably coupled with great complexity and hardship as the law attempts to mold itself around a new creation with characteristics the law was not designed to contemplate. Yet, if expeditious action is not taken to provide the required clarity, these effects felt within the bankruptcy bubble will undoubtedly have a ripple-effect pervasive enough to alter the ways in which businesses operate and effectively contract around cryptocurrencies.

A. *Cryptocurrency as a Currency*

Currencies receive the greatest amount of protections under the Bankruptcy Code, which explains why this is the widely-favored classification scheme by proponents of crypto-assets. If the Code considers cryptocurrencies as “currencies,” transactions involving these assets will receive protection from avoidance—as discussed *supra*—and from the constraints imposed by the “automatic stay.”⁴⁹ This would essentially give Bitcoin and other crypto transactions the same level of bankruptcy protection as transactions involving the exchange of U.S. dollars for other currencies, such as euros or yen.⁵⁰

Protection from avoidance under § 546(g) of the Code would allow an insolvent company to lawfully partake in pre-bankruptcy swap agreements of its crypto assets with creditors while avoiding the concern that said transactions could be reversed as “constructively fraudulent” by the trustee upon filing for bankruptcy.⁵¹ This has the ultimate effect of giving the debtor strategic power to plan before bankruptcy and prioritize certain creditors over others. For example, an insolvent subsidiary that chooses to sell its bitcoin holdings to its parent

49. See 11 U.S.C. §§ 362(b)(17), 546(g), 548, 560.

50. Deppert, *supra* note 6, at 146.

51. *Id.* at 147.

company for U.S. dollars would benefit from this protection.⁵² Without this protection, such transactions could only avoid the possibility of reversal if they were to have been made more than two years prior to the date of the bankruptcy filing. As bankruptcy tends to be an option of last resort, an entity will likely only realize the inevitability of its bankruptcy within two years of the filing of the bankruptcy petition. Thus, the potential avoidance protection to debtors that would result from classifying cryptocurrencies as a currency would—for better or for worse—significantly increase debtor autonomy by increasing debtor ability to plan ahead of the bankruptcy.

A currency classification for cryptocurrencies would also provide creditors with potential benefits. If considered a currency under the Code, cryptocurrency transactions between currencies—whether bitcoin-for-bitcoin or bitcoin for any other form of currency—would be considered “swap agreements,” for which § 560 of the Code gives broad protection against the an automatic stay.⁵³ An automatic stay is a court order that halts any collection efforts on the part of creditors, including litigation, and takes effect once the bankruptcy petition is filed.⁵⁴ The classification would mean that a creditor who is currently in litigation against a company in order to recover money owed under a contract must cease its pursuit once the defendant files its bankruptcy petition. While a creditor with a valid claim has a good chance of being made whole through its litigation, this probability plummets significantly when the litigation is stayed due to a bankruptcy. In that event, the creditor’s claim will be pooled with any and all other creditors who have valid claims against the debtor; each creditor will receive a prorated fraction of what they are owed based on the available assets. However, if swap agreements are to encompass transactions that include cryptocurrencies, parties can sue to enforce these contracts despite the automatic stay.⁵⁵ This gives a creditor a significantly better chance of realizing its interest in the contract. Alternatively, a creditor can use its interest in a swap agreement to offset, or “net out,” any debt

52. *Id.*

53. 11 U.S.C. § 560 (2012).

54. Doherty, *supra* note 12, at 39.

55. *Id.*

that it owes to the debtor.⁵⁶ This advantage is of particular importance because parties will often calculate their credit exposure when it comes to swap agreements on a net basis for all of their transactions.⁵⁷ Giving parties the option to offset their debt based on their interest in cryptocurrency swap agreements affords more autonomy to creditors to strategically navigate a debtor's bankruptcy in a more advantageous way.

B. *Cryptocurrency as a Commodity*

If cryptocurrencies are deemed “commodities” under the Bankruptcy Code, it would afford debtors significantly less protections. Commodity contracts are not generally exempted from the automatic stay and would be subject to avoidance. However, there is one specific type of commodity transaction to which the Code will afford substantial protections—forward contracts. Section 101(25)(A) of the Bankruptcy Code defines a forward contract as any contract for the purchase, sale, or transfer of a commodity “with a maturity date more than two days after the date the contract is entered into.”⁵⁸ These contracts essentially allow parties to agree in the present to either buy or sell a commodity at its current market price, where the execution of such transaction would follow at a future agreed upon date. For example, if the current market price of one apple is 10 cents and a grocery store chain believes that the price of apples will go up in the next month, it may choose to enter into a forward contract with its supplier whereby it agrees to buy 100,000 apples at 10 cents per apple, executing the purchase two months from today. Forward contracts function as an instrument that allows parties to mitigate their risk; to reward this function, the Bankruptcy Code offers forward contracts immunity from an automatic stay, preservation of their contractual rights, and the ability to continue “business as usual.”⁵⁹

As forward contracts are designed for speculators whereby they may hedge their bets with volatile assets, this form of protection would be specifically useful for cryptocurrencies which are infamous for their extreme volatility. Insofar as transac-

56. 5 COLLIER ON BANKRUPTCY, ¶ 560.05 (16th 2019).

57. *Id.*

58. 11 U.S.C. § 101(25)(A) (2012).

59. Deppert, *supra* note 6, at 148; *see also* 11 U.S.C. § 556 (2019).

tions involving Bitcoin or other forms of cryptocurrency would qualify as “forward contracts” under the law, they would qualify for these benefits if classified as commodities.⁶⁰ Some argue that a commodity would mean that some agreements involving cryptocurrencies would qualify as “other commodity agreement[s]” under the Code, thus receiving swap treatment protections.⁶¹ Yet still, as there is currently no case law to date interpreting “other commodity agreement,” no clear meaning has been codified, resulting in nothing more than speculative interpretations.⁶²

The protections offered by a commodity classification regime are much narrower in comparison to those available to currencies. Thus, the fact that cryptocurrencies’ status under the Bankruptcy Code is still undefined leaves both debtors and creditors uncertain about the true extent of their liabilities. If not remedied, this alone could drastically slow the growth of cryptocurrency use in the American economy.

C. Price Volatility

Lack of classification is hardly the only bump in the road for cryptocurrencies when it comes to bankruptcy. The unique price volatility of untethered cryptocurrencies poses significant dangers to creditors and debtors, as the Bankruptcy Code in its current formulation fails to consider such dramatic price fluctuations. For example, gold’s typical 30-day standard deviation is 1.2%, meaning its price will, on average, fluctuate plus or minus 1.2% over a given month.⁶³ Broad-based stock in-

60. It is worth noting that futures contracts are popular among Bitcoin enthusiasts, yet futures contracts are technically different than forward contracts. Because futures contracts are traded on an exchange, and that daily changes are “settled” on a daily basis, it is unclear whether these contracts would qualify for protection as a commodity forward contract as defined by § 101(25)(A). See Albert Phung, *Forward Contracts vs. Future Contracts: What’s the Difference?*, INVESTOPEDIA (Apr. 9, 2019), <https://www.investopedia.com/ask/answers/06/forwardsandfutures.asp>.

61. 11 U.S.C. § 101(53B)(A)(i)(II) (2012); Shayna Rochester & Lindsay Lersner, *What Happens When Crypto Meets Insolvency?*, LAW360, n.15 (Feb. 7, 2019), <https://www.law360.com/articles/1116999/what-happens-when-cryp-to-meets-insolvency>.

62. Rochester & Lersner, *supra* note 61, at n.15.

63. Sean Williams, *How Volatile is Bitcoin?*, THE MOTLEY FOOL (May 10, 2018), <https://www.fool.com/investing/2018/05/10/how-volatile-is-bitcoin.aspx>.

dexes will tend to have a standard deviation of 0.5% to 1%.⁶⁴ By contrast, as of May 2019, Bitcoin has a standard deviation of 3.42%—almost three times greater a deviation than that of gold.⁶⁵ When looking at year-long performance, in 2017 alone, bitcoin increased in value by almost 1,400% despite dropping in value by at least 30% on five separate occasions within that twelve-month period.⁶⁶ Additionally, when looking at the market as a whole in that same year, the combined value of all digital currency market caps increased by more than 3,300%.⁶⁷ As other more traditional asset classes reflect significantly milder volatility, the Code as it stands is insufficient to address a security like crypto. However, issues over how to properly value these exceptionally volatile assets, coupled with the Code's designated timelines on when to liquidate assets, can have serious repercussions on all parties involved in a bankruptcy.

This point is exemplified in the case of Mt. Gox. In 2014, Mt. Gox—one of the largest Bitcoin exchanges—filed for bankruptcy in Japan after 650,000 bitcoins were stolen in an act of cybertheft.⁶⁸ At the time it filed for bankruptcy, Mt. Gox had approximately 202,000 bitcoins to be put in the bankruptcy estate for the thousands of creditors' claims against it.⁶⁹ During the course of the bankruptcy, the price of Bitcoin shot up so significantly that in 2018 the trustee had funds valued at approximately \$1.5 billion. With such a dramatic increase in value, the trustee estimated that by valuing the creditors' claims based on the market value of Bitcoin at the time of the bankruptcy filing, it would be able to liquidate the bitcoins at the current market price, pay all the creditors' claims in full, and still retain a surplus of \$1 billion.⁷⁰ Holding on to the as-

64. *Id.*

65. THE BITCOIN VOLATILITY INDEX, <https://bitvol.info> (last visited May 15, 2019).

66. Williams, *supra* note 63, ¶ 3.

67. *Id.* ¶ 1.

68. Illman & Cox, *supra* note 21, at 4.

69. *Id.*

70. *Id.* This was the position of Mt. Gox in 2018, although it does not appear that the creditors' claims have actually been paid out at this point in time. Additionally, a creditor's claim is not automatically determined by the value of bitcoin on the date of the bankruptcy petition's filing. For example, a creditor may argue that she is entitled to the bitcoin itself (or the current market price of the bitcoin), as opposed to its value on a particular date.

sets and waiting to liquidate astronomically increased the value of the bankruptcy estate—to the creditor’s benefit. In this specific instance, the volatility of cryptocurrencies led to an overall better result for both the debtor and the creditors.

Having the option to hold onto certain assets can give the trustee, as well as the creditors, the opportunity to plan strategically and attempt to maximize the bankruptcy estate. However, depending on which bankruptcy chapter an entity files under, this will not always be a viable option. For example, a Chapter 7 bankruptcy entails a complete liquidation of all of the debtor’s nonexempt property. Typically, a trustee in this situation will sell the company’s assets as soon as possible in order to quickly pay back the creditors.⁷¹ Due to the trustee’s duties under Chapter 7, it is unlikely that a trustee would forego an immediate sale of cryptocurrency assets in the hope that it could increase the estate’s value in the future, despite the fact that creditors may prefer it.⁷² Now, consider for a moment a hypothetical world in which Mt. Gox filed for bankruptcy in the United States under Chapter 7. The trustee, in following its duty, would have quickly sold off the bitcoins upon the filing of the petition—selling all its assets before the price surge and limiting the creditors recovery to merely pennies on the dollar. Chapter 7 was simply not constructed with such extreme volatility in mind. Yet, by failing to allow flexibility within the Code to account for aberrations that do not fit the typical mold, this Mt. Gox hypothetical nightmare may soon become a reality for U.S. individuals.

Although Chapters 11 and 13 allow more of an opportunity to plan strategically—in that they require the submission of a reorganization or repayment plan—this does not solve cryptocurrency’s volatility problem. Holding on to its bitcoins ended well for Mt. Gox, but this will not always be the case. It is extremely difficult to predict if and when cryptocurrency prices will rise. The price of Bitcoin could just have easily plummeted to zero, leaving the creditors significantly worse off than before. A Chapter 11 debtor with predominately crypto assets could have sufficient funds to satisfy its claims on

This is similar to the argument discussed in *Hashfast Technologies*, *supra* Section I-A.

71. Illman & Cox, *supra* note 21.

72. *Id.*

one day and be significantly wiped out the next day.⁷³ The question of how to deal with this fact is not an easy one to answer. Whether the best course of action would be to allow the trustee more discretion when it comes to volatile assets or to give creditors more autonomy to choose to gamble their interests on market speculation, or something entirely different, it is clear that something must be done.

D. *Stable Coins and Ownership*

Despite the fact that stablecoins are *literally* more stable than their untethered counterparts—due to the fact that they are backed by an underlying asset—these types of cryptocurrencies suffer from a unique bankruptcy issue of their own. While the “owner” of the stablecoin may hold the coin in a digital wallet, the underlying asset is held by the custodian, which tends to be a bank or other type of institution.⁷⁴ In the context of insolvency, it is unclear on the surface which party technically has ownership of the underlying asset—the coin holder or the custodian. The answer could depend on the structure of each individual stablecoin. If a stablecoin only gives the holder a contractual right to the underlying asset, a bankruptcy court may consider the underlying asset to be part of an insolvent custodian’s bankruptcy estate.⁷⁵ The owner of the stablecoin would be treated as a creditor of the insolvent custodian, along with anyone else holding a valid claim. Conversely, if a stablecoin is designed in a way that affords absolute ownership to the holder, then perhaps the bankruptcy courts would treat the insolvent custodian as a modified form of an escrow agent.⁷⁶ Whether or not that is the case, the sheer fact that there is ambiguity over who truly owns the value underlying a stablecoin adds additional unwarranted complications to bankruptcy law and makes it increasingly difficult for parties to understand their true level of exposure.

E. *Security Interests under UCC Article 9*

As discussed *supra*, the UCC does not classify cryptocurrencies as a type of currency because it fails to meet the defini-

73. Helman & Wedoff, *supra* note 1.

74. Rochester & Lersner, *supra* note 61.

75. *Id.*

76. *Id.*

tional requirement of being “authorized or adopted by a domestic or foreign government.”⁷⁷ This means that cryptocurrencies will likely be considered a “general intangible” under the UCC, as they fail to fit neatly within the definitions of any other category of collateral classes that it lists.⁷⁸ The nature of general intangibles, though, creates troubling implications for the future of cryptocurrencies. One reason for this is rooted in the fact that a party can perfect a security interest in a general intangible by simply filing a financing statement in the jurisdiction where the debtor is located.⁷⁹ Comparatively, a security interest in money is only obtained through direct possession of the asset, so when a party receives a \$20 bill it does not need to worry about any claims on that bill. Once a party perfects their interest on a general intangible it “continues in collateral notwithstanding sale, lease, license, exchange or other disposition thereof unless the secured party authorized the disposition free of the security interest.”⁸⁰ For example, a bank that offers a loan to a person in order to purchase a car will have a security interest in the physical car—the general intangible.⁸¹ Whatever the person chooses to do with the car, the security interest will remain intact unless the bank says otherwise. For cryptocurrencies, this means that a security interest would remain perfectly attached to a bitcoin or other type of cryptocurrency even after a merchant accepts it as payment from a customer.⁸² Unlike money under the UCC, bitcoins as general intangibles could, unbeknownst to the innocent holder of the bitcoin, be encumbered with valid claims.

This prospect becomes even more troubling in the context of what is colloquially known as a “blanket lien.” To illustrate this point, assume that a coffee shop takes out a loan from the bank. It is common for the bank to secure the loan

77. Helman & Wedoff, *supra* note 1; U.C.C. § 1-201(b)(24) (AM. LAW INST. & UNIF. LAW COMM’N 1977).

78. Helman & Wedoff, *supra* note 1. Cryptocurrencies do not fit the definition of “investment property” because they are not considered a form of “security.” *Id.*; see also U.C.C. §§ 8-102(15), 9-102(49).

79. Helman & Wedoff, *supra* note 1.

80. U.C.C. § 9-315(a)(1).

81. Bob Lawless, *Is UCC Article 9 the Achilles Heel of Bitcoin?*, CREDIT SLIPS (Mar. 10, 2014), <https://www.creditslips.org/creditslips/2014/03/is-ucc-article-9-the-achilles-heel-of-bitcoin.html>.

82. Helman & Wedoff, *supra* note 1.

with collateral in the form of the coffee shop's equipment, inventory, accounts, and "general intangibles"—the blanket lien.⁸³ This appears to make perfect sense on the surface. However, suppose the coffee shop decides it would like to begin accepting bitcoin as a form of payment for its coffee and baked treats. When a customer chooses to pay for her iced latte with bitcoin, this becomes a general intangible of the coffee shop. Thus, it becomes part of the bank's collateral under the blanket lien.⁸⁴ Even if the coffee shop uses those bitcoins to subsequently purchase coffee beans from its supplier, UCC § 9-315(a)(1) says that the bank's security interest on the bitcoins would remain.⁸⁵ Under this scenario, the bank could theoretically go after the coffee bean supplier to enforce its claim on the bitcoins, cutting out the coffee shop altogether.

In the bankruptcy context, encumbered claims on a debtor's assets could only add additional strain and controversy to the bankruptcy estate. Imagine a debtor who files for bankruptcy because it is unable to pay back its creditors, only to find out that of the unsubstantial assets that it has, many of its crypto assets already have prior claims against them. This not only hurts the creditors' chances of recovery, but also the debtor's chances of securing a fresh start for itself. Additionally, when a creditor decides to loan money to a company because it sees that it has a healthy stock of crypto assets, the creditor could be falsely believing that its loan is more protected than it is in reality. If bankruptcy law waits to address these issues until it has angry creditors in front of them, it will be too late.

* * *

Bitcoin and other cryptocurrencies have caught the attention of the world as they have displayed signs of growth never before seen in an asset class. They have also pushed the boundaries of the imagination in finding a unique, alternative way to cut out third-parties within financial transactions. But with this exceptional uniqueness comes equally unique challenges in retrofitting current law in a way that effectively accommodates them. Thus far, courts and other governmental bodies have been slow to adjust, and of the ones that have,

83. Lawless, *supra* note 81.

84. *Id.*

85. *Id.*

they have failed to act uniformly in their direction. The consequences of this ambiguity on bankruptcy law is particularly troubling, as bankruptcy is already a grueling process for all parties involved. With the lack of a uniform classification, the extreme volatility, the ownership issues, and the possibility of unexpected security interests encumbering them, cryptocurrencies appear to be a toxic asset in the bankruptcy realm. Clarification on these matters is paramount in order to detoxify this asset and allow parties to make informed decisions when contracting over them. Failure to act may have the unfortunate effect of inhibiting cryptocurrency's true potential as a beneficial asset of the future.