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2019 Alexander L. Paskay Memorial Bankruptcy Seminar

A Primer on Digital Currency and Blockchain

Hon. Roberta A. Colton, Moderator

U.S. Bankruptcy Court (M.D. Fla.); Tampa

Robert A. Cox, Jr.

Bradley Arant Boult Cummings LLP; Charlotte, N.C.

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43rd Annual Alexander L. Paskay Memorial Bankruptcy Seminar

February 6-8, 2019; Tampa, Florida

A Primer on Digital Currency and Blockchain

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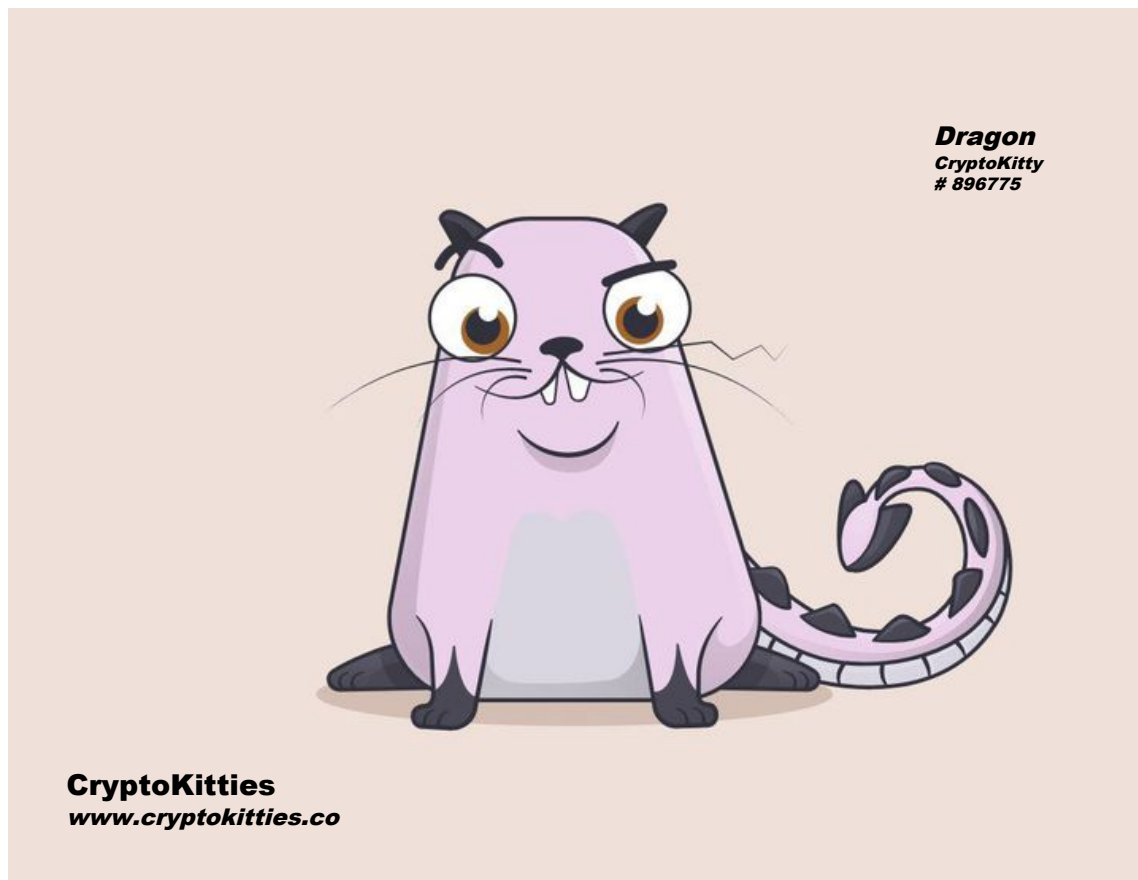
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Materials Outline:

- | | |
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| I. Introduction to Blockchain | Robert A. Musiala, Jr. |
| II. Secured Creditor's Guide to Securing and Perfecting a Security Interest in Cryptocurrency | Stephanie C. Lieb |
| III. Blockchain, Cryptocurrency & Smart Contracts: Background, Use and Bankruptcy Implications | John B. Hutton, III |
| IV. The Treatment of Cryptocurrencies in Bankruptcy: A Lot of Unanswered Questions | Robert A. Cox, Jr. |



February 7, 2019

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Introduction to Blockchain

Robert Musiala, Counsel, BakerHostetler

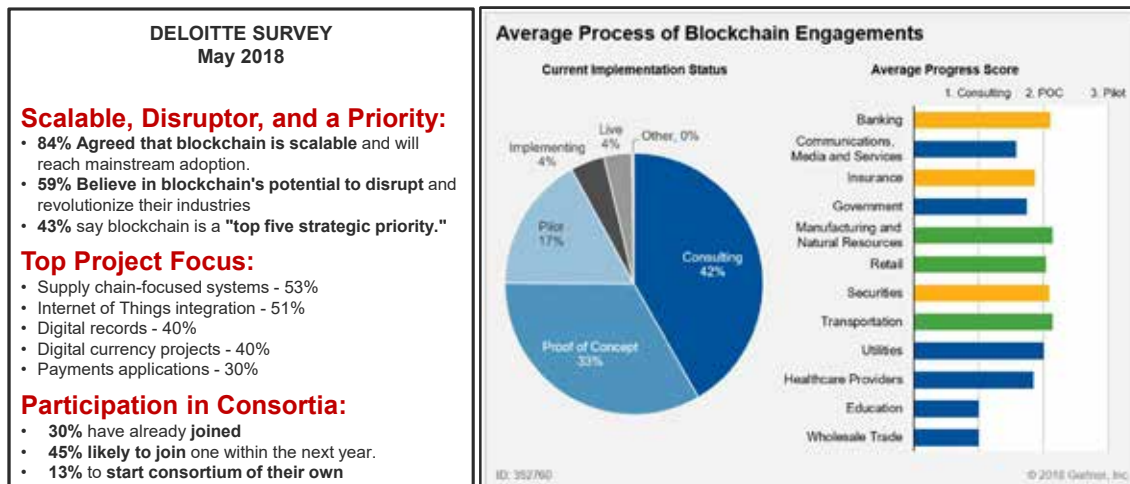
Blockchain Technology and Digital Currencies

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Why Blockchain? Why Now?



Testing on the Rise Across Industries



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Blockchain Continues to Gain Attention

On **August 28, 2018**, both PwC and Deloitte published the results of their **global executive surveys on blockchain**. Highlights include the following:

- **84%** are actively involved with blockchain.
- **84%** believe blockchain will achieve mainstream adoption.
- **74%** see a compelling business case for blockchain.
- **69%** anticipate replacing current recordkeeping systems with blockchain.
- **68%** perceive a competitive disadvantage if they do not adopt blockchain.

<https://www.pwc.com/gx/en/issues/blockchain/blockchain-in-business.html>

<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-2018-global-blockchain-survey-report.pdf>

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What is a Blockchain?

A blockchain is a cryptographically secured transaction network and ledger that is shared among and verified by all computer nodes participating in a distributed system.

Key characteristics of blockchain include ...

1	2	3	4
Distributed Network	Cryptography	Immutability	Disintermediation
Multiple independent computer nodes support the network and verify updates.	The integrity of information stored on a blockchain is secured by public-private key cryptography.	Every transaction is linked to the previous transaction, making it (practically) impossible to alter network data.	Characteristics 1-3 enable trusted peer-to-peer transactions, without using a central authority as intermediary.

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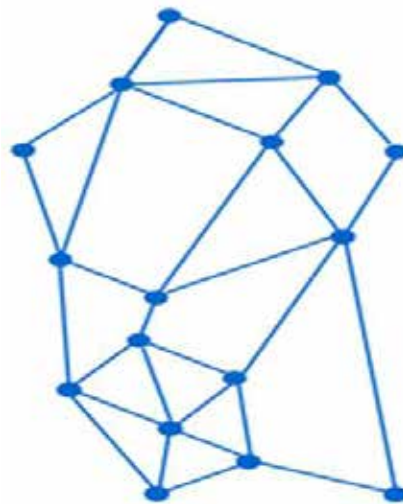
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1 Distributed Network

Traditional Centralized Network



Distributed Network

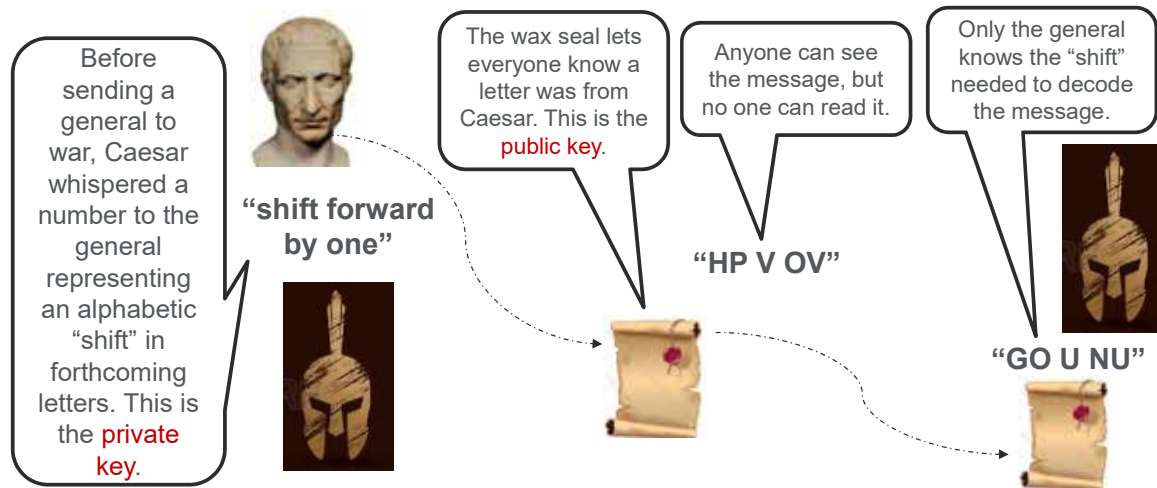


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2 Public-Private Key Cryptography

Public-private key cryptography was formalized in the 1970s but can arguably be traced back to Julius Caesar, who in 58 B.C. is claimed to have invented the **Caesar Cipher**, a technique used to encrypt Roman military communications.



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2 Public-Private Key Cryptography

The Roman military used the **Caesar Cipher** technique for almost 800 years, until **Al-Kindi**, an Arab mathematician, cracked the code. **Al-Kindi** analyzed the frequency with which each letter in the Latin language was used, then systematically applied the most probable "shifts" until a message was decoded.

Hp! V Opsuixftufo!
Csfb! sjhiu uispyhi uibu mjo**f**.
Xjui pvs dpmpst gmzjoh, X**f** xjmm di**ff**s zpv bmm u**if** u**jnf**.
V! Sbi! Sbi!
Hp! V Opsuixftufo!
Gjhiu gps wjdupsx.
Tq**sf**be gbs u**if** g**bnf** pg pvs gbjs obn**f**.
Hp Opsuixftufo, xjo uibu hbn**f**!

Al-Kindi first identified the most frequent letter used in the coded message.

assume "f"
is "e"

shift back
by one

He then substituted the most frequent letter used in the language, identified the shift, and shifted all other letters accordingly.

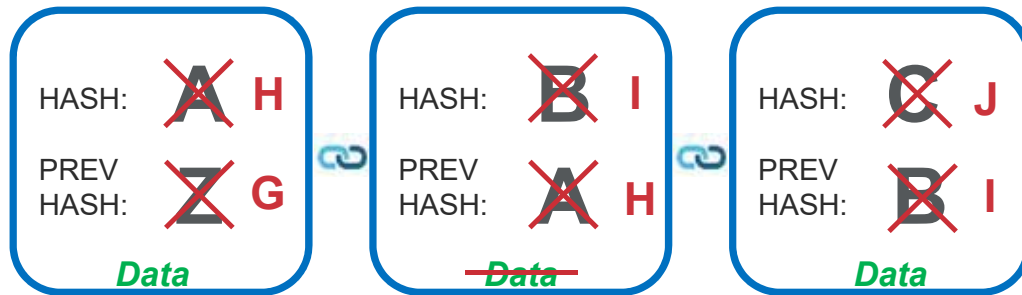
Go! U Northw**est**ern!
Br**ea**k right through that line.
With our colors flying, We will ch**ee**r you all the time.
U! Rah! Rah!
Go! U Northw**est**ern!
Fight for victory.
Sp**re**ad far the fa**m**e of our fair name.
Go Northw**est**ern, win that ga**m**e!

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3 Hashing and Data Immutability

Each “block” contains its own unique hash (which is dependent on the hash of the previous block), as well as the actual hash of the previous block. Altering the data in a block will alter its hash – thereby altering the hashes of all other blocks in the blockchain.



Sample Hash from the Bitcoin Blockchain:

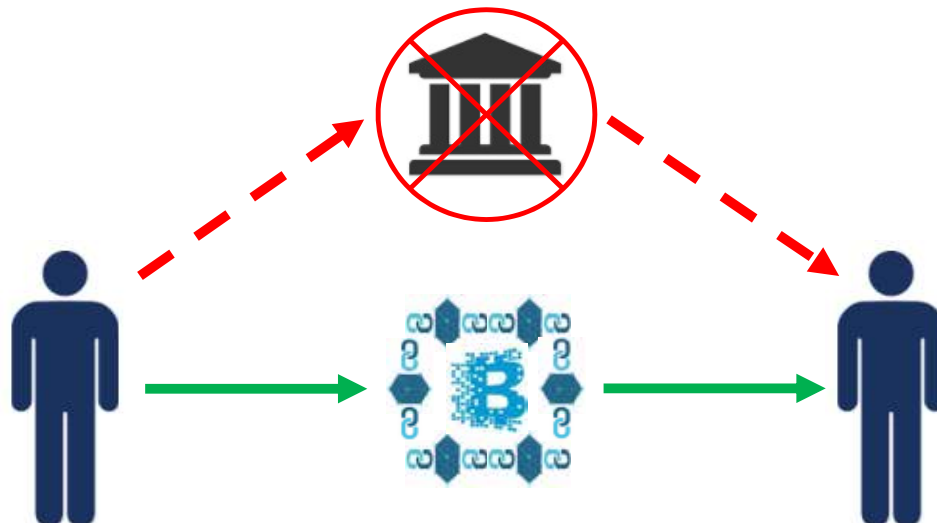
000000000000000000000000098983c6e67bec9488da5f55f2842e2f01cf7188f33912

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4 Disintermediation

Distributed networks take control away from any single party; cryptography secures P2P transactions; and hashing makes the data trustworthy. The result:
Third parties are no longer needed to facilitate internet-based transactions.

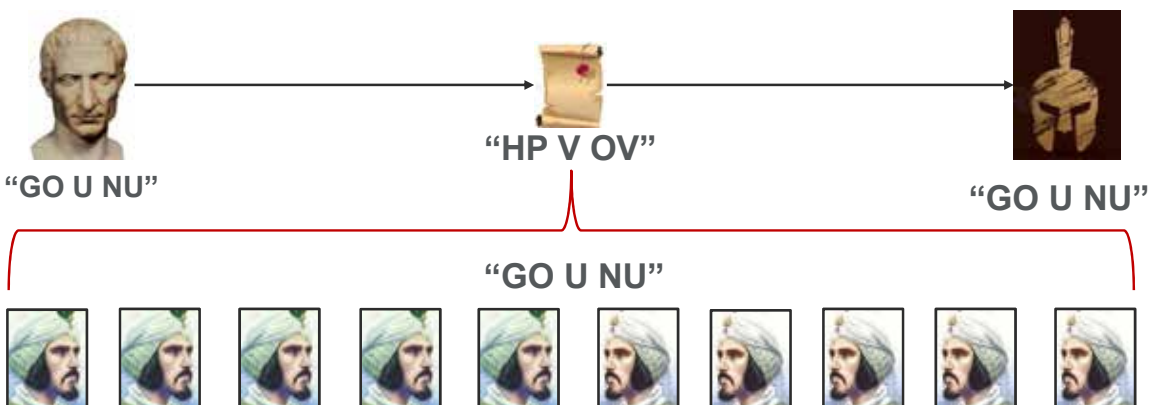


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Bitcoin: The “Proof of Concept”

Bitcoin is the world’s first implementation of blockchain. The bitcoin network is supported by “miners” who download open source software and compete to solve complex algorithms that verify the integrity of transactions among network participants, like Al-Kindi decoding an encrypted message.

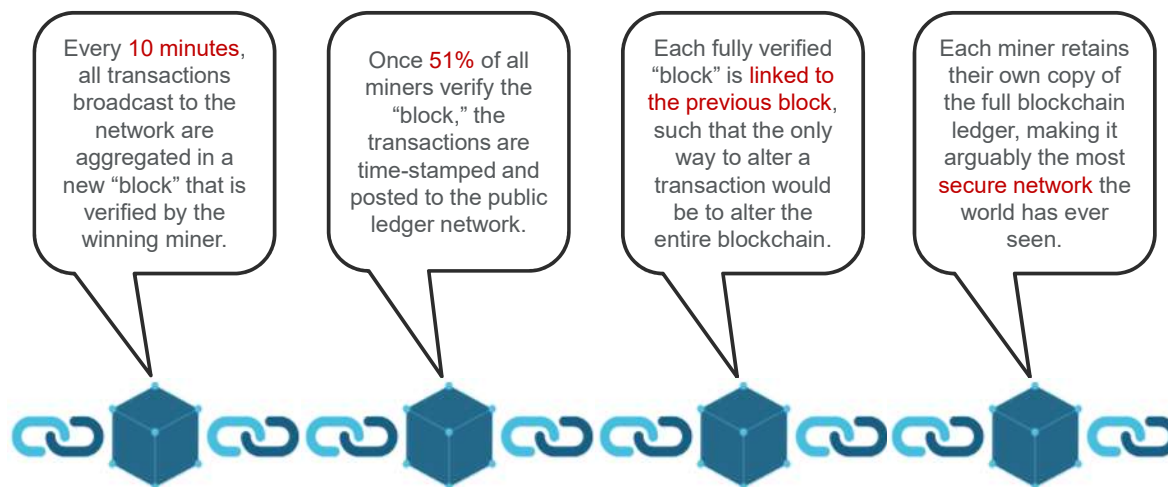


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Bitcoin: The “Proof of Concept”

Bitcoin solved the problem of “double-spending” by enabling direct peer-to-peer transfer of the asset itself – rather than a copy of the asset.



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Bitcoin: The “Proof of Concept”

The early years of bitcoin were marked by excitement over the disintermediation of the financial services industry, concerns over illegal activity and new disruptive businesses.

The new technology offered by bitcoin was embraced by both criminal actors and mainstream businesses ...



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Bitcoin: The “Proof of Concept”

More recently, bitcoin has been marked by wild price fluctuations and institutional trading.

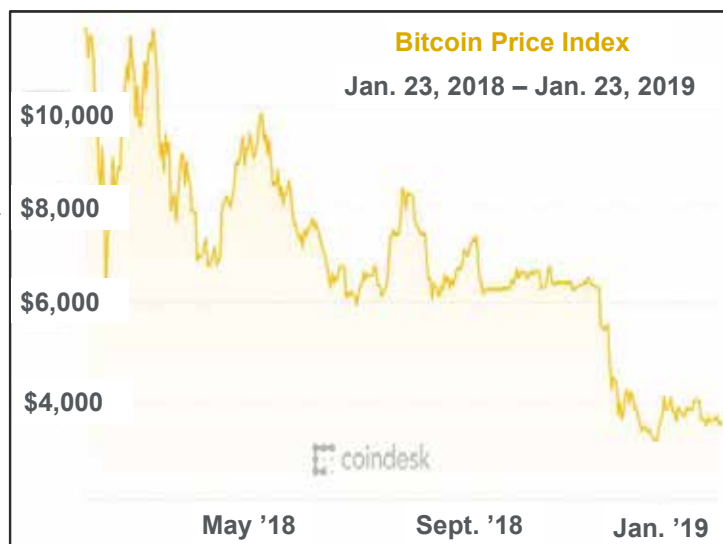
2014 – Institutional bitcoin trading firms emerge.



Dec. 2017 – CBOE, CME launch bitcoin futures.



May 2018 – Goldman to begin trading bitcoin.

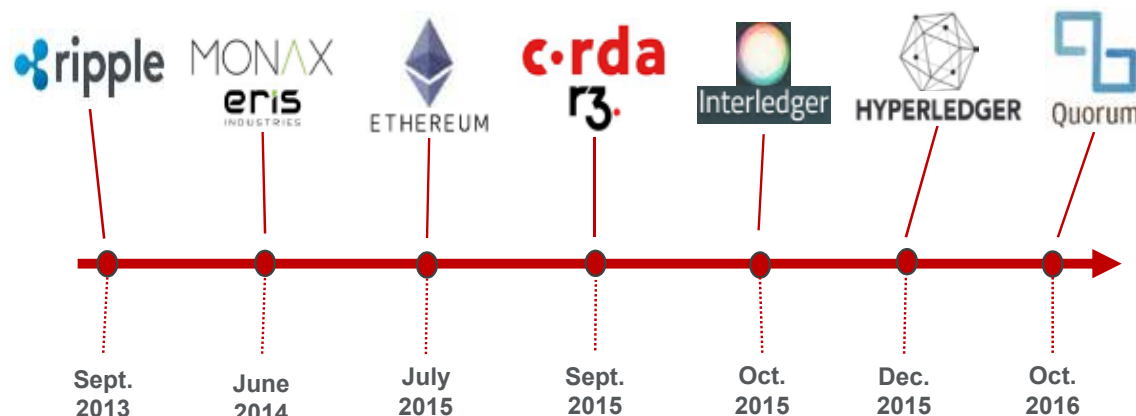


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Blockchain for Enterprise

By 2015, technologists studying bitcoin and its underlying technology collectively came to two simple – yet groundbreaking – revelations: “Cryptocurrencies” need not have anything to do with currency, and blockchain technology could be engineered and implemented independently of the bitcoin blockchain.



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Blockchain for Enterprise

When multiple parties use the same dataset, blockchain may reduce costs, enhance security and increase data accuracy and auditability. A key threshold question is whether to implement a public/permissionless or private/permissioned blockchain.



Blockchain may drive efficiencies in situations where multiple business entities ...



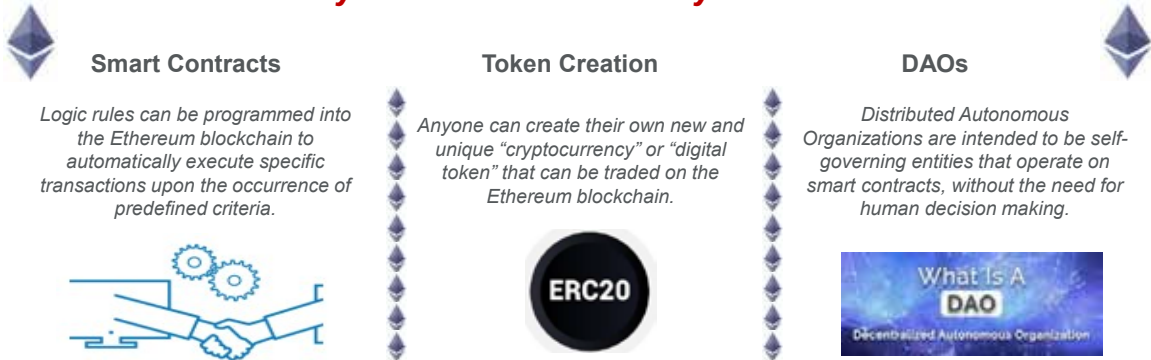
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Ethereum: Public Blockchain 2.0

Financed by crowdfunding and launched in July 2015, Ethereum seeks to harness the inherent characteristics of bitcoin to create a new public, permissionless blockchain network intended to be used as a public platform for enterprise application development – in contrast to the payment system intended by bitcoin.

Some of the key innovations offered by Ethereum include ...

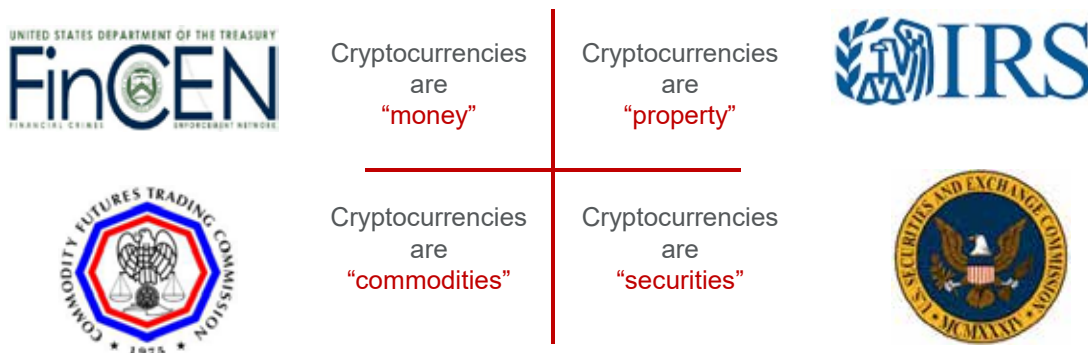


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U.S. and Foreign Regulation

In the U.S., various federal agencies and courts have defined cryptocurrencies as falling into a variety of legal asset classes, depending on the situation. Similarly, international legal frameworks are inconsistent and constantly evolving.



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Contact for Questions



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<https://www.theblockchainmonitor.com/>

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Creditor's Guide to Securing and Perfecting a Security Interest in Cryptocurrency

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Taking it Step by Step

- I. Analyze the Digital Currency to be Pledged
- II. Determine the Best Fit for Classification Under the UCC
- III. Perfect and Stay Vigilant



Analysis Phase: What Type of Digital Currency Does the Borrower Own?

- Over 1,600 cryptocurrencies exist
- Three Main Categories Currently:
 1. Coins (Bitcoin)
 2. Utility Tokens (Ethereum)
 3. Tokenized Securities (Ripple)



Analysis Phase: How Is the Borrower Using the Digital Currency?

- Use influences categorization and classification of the type of collateral.
 - Currency
 - Commodity
 - Security
- Do governmental entities provide guidance?



Decision Phase: Process of Elimination

- What it likely is NOT:
 - Money
 - Instrument
 - Inventory
 - Deposit Account
- What it COULD be:
 - General Intangible
 - Investment Property (Article 8)



Decision Phase: Perfecting a Security Interest in a General Intangible

- Security Agreement
- UCC-1 Financing Statement
 - Jurisdiction where debtor is located
 - Describe the collateral
 - Blanket description of “All digital currency owned by Stephanie Lieb.”
 - Specifically identify a wallet address
 - Don’t forget about proceeds



**Secured Creditor's Guide to Securing and
Perfecting a Security Interest in Cryptocurrency**

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Trenam Law, Tampa, Florida

Ashlyn L. Robinson
Trenam Law, Tampa, Florida

I. Introduction

These materials, and this program, are designed to assist practitioners in determining how to properly perfect a security interest in the various forms of cryptocurrency. The industry of cryptocurrency is an ever-evolving one, as is the legal landscape. As the landscape morphs, so can the rules of perfection.

II. Securing and Perfecting: The Basics

As you know, there are certain recognized forms and categories of collateral under Article 9 of the Uniform Commercial Code. These categories (goods, equipment, inventory, money, and intangibles) have legal significance as they are governed by different rules for perfection of the security interest.¹ The most common ways to perfect a security interest are by filing a UCC-1 financing statement describing the collateral with sufficient specificity, by possession, and by control.²

When it comes to cryptocurrency as a form of collateral, we cannot squarely fit cryptocurrency into any of the existing categories under Article 9. We must look carefully at the character of the collateral to determine the best fit.

III. Analyzing the Cryptocurrency Collateral to Be Pledged

The security and perfection analysis begins with a determination of the type of cryptocurrency the borrower holds and how it is being used.

¹ See UCC § 9-301 through § 9-342.

² See UCC § 9-501 through 9-527; UCC § 9-310; UCC 9-313.

A. What Type of Cryptocurrency does the Borrower Own?

Over 1,600 cryptocurrencies exist; however, they all serve different purposes and are treated differently.³ Three main categories of cryptocurrencies currently exist: coins, utility tokens, and tokenized securities.⁴

1. Coins: These are “decentralized digital currencies that use encryption techniques to regulate the generation of units of currency and verify fund transfers.” An example of a coin would be Bitcoin.⁵
2. Utility Tokens: A utility token is not purchased as an investment to gain profit; instead it is utilized for various purposes, such as gaining access to services or products located on a server. An example of a utility token would be Ethereum.⁶
3. Tokenized Security: A tokenized security is similar to a share of a business and carries with it an expectation of return on investment. An example of a tokenized security would be Ripple.⁷

B. How is the Borrower using the Cryptocurrency?

The way in which a borrower is using the cryptocurrency will influence whether it is categorized as a currency, a commodity, or a security.⁸ It is important to determine how the cryptocurrency is being used because, as explained below, the use of the cryptocurrency may affect the type of collateral it is classified as and ultimately affect the way a secured interest in the cryptocurrency is perfected.

A commodity is defined as a raw material that can be bought and sold. Some cryptocurrencies, like Ethereum, fall into this label when the cryptocurrency is used as fuel

³ Matthew Frankel, *How Many Cryptocurrencies Are There? Bitcoin, Ethereum, and Ripple are just the beginning*, FOOL.COM, <https://www.fool.com/investing/2018/03/16/how-many-cryptocurrencies-are-there.aspx> (Mar. 16, 2018); Molly St. Louis, *Not all Cryptocurrencies Are Created Equal*, YAHOO FINANCE, <https://finance.yahoo.com/news/not-cryptocurrencies-created-equal-172123085.html> (Dec. 21, 2017).

⁴ Molly St. Louis, *Not All Cryptocurrencies Are Created Equal*, YAHOO FINANCE, <https://finance.yahoo.com/news/not-cryptocurrencies-created-equal-172123085.html> (Dec. 21, 2017).

⁵ *Id.*

⁶ *Id.*; Matthew T. McClintock, *Understanding Wyoming's 2018 Blockchain Laws A Model for Industry Regulation*, 41 Wyo. Law. 40, 41–42 (June 2018).

⁷ Molly St. Louis, *Not All Cryptocurrencies Are Created Equal*, YAHOO FINANCE, <https://finance.yahoo.com/news/not-cryptocurrencies-created-equal-172123085.html> (Dec. 21, 2017).

⁸ *Id.*; Public Statement, *Statement on Potentially Unlawful Online Platforms for Trading Digital Currencies*, SECURITIES EXCHANGE COMMISSION, (Mar. 7, 2018), <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>.

for the implementation and enforcement of smart contracts.⁹ Currency, or money, is defined as “a medium of exchange currently authorized or adopted by a domestic or foreign government.”¹⁰ Cryptocurrencies are treated as currencies when they are used to purchase materials online¹¹; however, to date the United States has not recognized cryptocurrencies as an official medium of exchange.¹² A security, put simply, is any debt that has been assigned a value and sold. Whether a cryptocurrency will be classified as a security is determined by analyzing the cryptocurrency and use of the cryptocurrency in conjunction with the *Howey Test*.¹³

C. How Have Governmental Entities Classified the Cryptocurrency?

Cryptocurrency classifications handed down from U.S. Courts or administrative bodies are few and far between.¹⁴ Classifications are also not consistent from agency to agency as different bodies have classified cryptocurrencies as different things such as a commodity¹⁵, property¹⁶, security¹⁷, and currency^{18,19}. Classifications are also not consistent from court to court as different courts have classified cryptocurrencies as a

⁹ Molly St. Louis, *Not All Cryptocurrencies Are Created Equal*, YAHOO FINANCE, <https://finance.yahoo.com/news/not-cryptocurrencies-created-equal-172123085.html> (Dec. 21, 2017); Alyssa Hertig, *How do Ethereum Smart Contracts Work?*, COINDESK, <https://www.coindesk.com/information/ethereum-smart-contracts-work/> (Last visited Dec. 14, 2018 1:02 PM EST).

¹⁰ UCC § 1-201(B)(24).

¹¹ *United States v. Ulbricht*, 31 F. Supp. 3d 540, 540 (S.D. N.Y. 2014); *State v. Michell Abner Espinoza*, No. F14-2923 (Fla. Cir. Ct., Miami Dade County).

¹² See Andrew C. Helman & Carl N. Wedoff, *When Blockchain Meets Article 9 and Bankruptcy*, LAW360 (Feb. 9, 2018).

¹³ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

¹⁴ Madiha M. Zuberi, *The Bitcoin Identity Crisis: Currency or Property*, BAKERHOSTETLER, <https://www.copyrightcontentplatforms.com/2016/02/the-bitcoin-identity-crisis-currency-or-property/#page=1> (Feb. 17, 2016).

¹⁵ The Commodity Futures Trading Commission (CFTC), *CFTC Staff Issues Advisory for Virtual Currency Products*, U.S. COMMODITY FUTURES TRADING COMMISSION, <https://www.cftc.gov/PressRoom/PressReleases/7731-18> (May 21, 2018).

¹⁶ I.R.S. Notice 2014-21, INTERNAL REVENUE SERVICE, https://www.irs.gov/irb/2014-16_IRB#NOT-2014-21 (April 14, 2014) (officially categorizing cryptocurrencies as property for federal tax purposes).

¹⁷ Public Statement, *Statement on Potentially Unlawful Online Platforms for Trading Digital Currencies*, SECURITIES EXCHANGE COMMISSION, <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading> (Mar. 7, 2018).

¹⁸ United States Department of the Treasury Financial Crimes Enforcement Network (FinCEN), *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, UNITED STATES DEPARTMENT OF THE TREASURY FINANCIAL CRIMES ENFORCEMENT NETWORK, <https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering> (Mar. 18, 2013).

¹⁹ Francine McKenna, *Here's how the U.S. and the world regulate bitcoin and other cryptocurrencies*, MARKETWATCH, <https://www.marketwatch.com/story/heres-how-the-us-and-the-world-are-regulating-bitcoin-and-cryptocurrency-2017-12-18> (Dec. 28, 2017).

commodity²⁰, currency²¹, security²², and one court even chose to forego deciding whether bitcoins are commodities or securities, holding instead that bitcoins are not U.S. Dollars²³.

IV. Deciding How to Perfect Your Security Interest in Cryptocurrency

Once you have determined what type of cryptocurrency your borrower is offering as security, based on its designed function, how it is being used and government and court regulations, you are armed with the information to make the best determination as to how to perfect your security interest in the cryptocurrency collateral.

Article 9 provides many different categories collateral can be classified as. When analyzing collateral under Article 9, it is essential to determine the type of collateral offered in order to know how to perfect the secured interest in the collateral. An analysis of all potential classification for cryptocurrency is illustrative here.

A. What It is Not

Cryptocurrency will not be classified as money. The UCC defines money as a “medium of exchange currently authorized or adopted by a domestic or foreign government.”²⁴ At this point, the United States government has not authorized or adopted cryptocurrency as a recognized medium of exchange. Cryptocurrencies will not be classified as an instrument because instruments are defined as a “writing that evidences a right to the payment of a monetary obligation.”²⁵ Cryptocurrencies are not writings and the cryptocurrency itself is the item carrying the “monetary value.” Cryptocurrencies will not be categorized as inventory because inventory only includes tangible goods.²⁶ A cryptocurrency is not a physical, tangible good. Cryptocurrencies cannot fall into the classification of deposit account because deposit accounts are required to be maintained at a bank.²⁷ Cryptocurrencies are not maintained at banks. After analyzing all of the potential classes of collateral, there are only two categories that cryptocurrencies could fall into: general intangibles and investment property.²⁸

²⁰ Wolfe Zhao, *Cryptos Are Commodities, Rules US Judge In CFTC Case*, COINDESK, <https://www.coindesk.com/us-judge-rules-cryptocurrencies-are-commodities-in-cftc-case/> (last updated March 7, 2018 14:06 UTC) (quoting *Commodity Futures Trading Comm'n v. McDonnell*, 287 F. Supp. 3d 213, 228 (E.D. N.Y. 2018), *adhered to on denial of reconsideration*, 321 F. Supp. 3d 366 (E.D. N.Y. July 16, 2018)).

²¹ *United States v. Faiella*, 39 F. Supp. 3d 544, 545 (S.D. N.Y. 2014).

²² *SEC v. Shavers*, 4:13-CV-416, 2014 WL 4652121, at *4 (E.D. Tex. Aug. 6, 2013).

²³ *HashFast Techs. v. Lowe (In re HashFast Techs. LLC)*, No. 14-30725DM, Adv. No. 15-03011DM (Bankr. N.D. Cal. Feb. 22, 2016).

²⁴ UCC § 1-201(b)(24).

²⁵ UCC § 9-102(47).

²⁶ See UCC § 9-102(48).

²⁷ UCC § 9-102(29).

²⁸ UCC § 9-102(42); UCC §§ 8-102(15), 9-102(49).

B. A General Intangible

A general intangible is essentially a catch-all category for those items not fitting into a different classification and includes “any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction.”²⁹ It is unquestionable that cryptocurrencies would likely be considered a general intangible as an item of personal property that does not fall into any other clearly defined category of collateral. In addition, cryptocurrencies may be considered investment property which is defined as “a security, whether certified or uncertified, security entitlement, securities account, commodity contract, or commodity account.”³⁰ however, this is contested. Some authors have blatantly stated that cryptocurrencies are not investment properties because they are not securities.³¹ It is possible though that authors making this determination have not considered how the cryptocurrency is being used.³²

Once a creditor has classified the type of collateral the borrower is using, it is then necessary to determine how to perfect the secured interest in that collateral.

Coins and Utility Tokens will likely be categorized as general intangibles; therefore, perfection of an interest in coins and tokens would occur through filing a UCC-1 financing statement in the jurisdiction where the debtor is located.³³ A financing statement will only be sufficient if it provides the name of the debtor, the name of the secured party or representative thereof, and indicates the collateral.³⁴ Collateral will be considered sufficiently indicated if it complies with UCC § 9-108 or indicates that the financing statement covers all assets or personal property.³⁵ Filing a financing statement that covers all personal property generally would encompass cryptocurrencies; however, the description required is not so cut and dry when filing a UCC-1 financing statement only pertaining to cryptocurrencies.

In the event of filing a financing statement only covering cryptocurrencies, the description of the collateral will have to comply with UCC § 9-108. The description will have to reasonably identify the cryptocurrency through a specific listing, category, type of collateral, quantity, computational or allocational formula or procedure, or through any other method by which the identity of the collateral will be objectively determinable.³⁶ A

²⁹ UCC § 9-102(42).

³⁰ UCC § 9-102(49).

³¹ See e.g., Andrew C. Helman & Carl N. Wedoff, *When Blockchain Meets Article 9 and Bankruptcy*, Law360 (Feb. 9, 2018).

³² *Supra* Part III (B); *Security Interests In Investment Property*; FINDLAW.COM, <https://corporate.findlaw.com/business-operations/security-interests-in-investment-property.html> (Dec. 16, 2018).

³³ See *id.*; UCC §§ 9-307, 9-301, 9-507.

³⁴ UCC § 9-502(a).

³⁵ UCC § 9-504.

³⁶ UCC § 9-108(a)–(b).

possible description for a financing statement will be the address and access key of a cryptocurrency wallet. To own cryptocurrencies, a user must have a cryptocurrency wallet.³⁷ Therefore, a secured party could use the following description on a financing statement to secure cryptocurrencies: “All cryptocurrency contained within the wallet with the following address and access key.” Or, a secured lender could simply describe the cryptocurrencies as “all cryptocurrencies owned by [name of cryptocurrency owner].” The description will likely depend on the amount of cryptocurrency owned by the debtor in conjunction with the amount used as collateral.

C. An Investment Property

Tokenized Securities may be categorized as investment property because these types of cryptocurrencies are treated as securities. A security is defined as “an obligation of an issuer or share, participant, or other interest in an issuer or in property or an enterprise of an issuer which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose on behalf of the transferor.”³⁸ There are two types of securities, those with certificates and those without.³⁹ Perfection of an interest in a security can occur through delivering the security certificate documenting the security to the lender or by filing a financing statement with the proper government entity.⁴⁰ Which perfection method used will likely be determined based on whether the security is certificated or uncertificated. In the context of cryptocurrencies treated as securities, if the investor does not receive a certificate, then perfection would occur through filing a UCC-1 financing statement. As discussed above, the lender would have to ensure that the financing statement is sufficient. However, if the cryptocurrency investor receives a security certificate, which is simply “a certificate representing a security,”⁴¹ perfection can be achieved by delivering the certificate to the lender.

Should a Tokenized Security be considered investment property, the transfer of the security along with the proper perfection would be influenced by Article 8 of the UCC which governs any instrument deemed suitable for trading according to securities markets.⁴² Under Article 8, a bona fide purchaser acquires perfect title to the security.⁴³ However, this discussion of cryptocurrencies as securities may be moot as there was a bill

³⁷ *What is a Cryptocurrency Wallet?*, CRYPTOCURRENCY FACTS, <https://cryptocurrencyfacts.com/what-is-a-cryptocurrency-wallet/> (Dec. 28, 2018) (“Essentially a wallet is like your online bank account platform, your address is like your account number, and the blockchain is like the bank’s ledger.”).

³⁸ UCC § 8-102(15).

³⁹ See UCC § 8-102(16), (18).

⁴⁰ *Security Interests In Investment Property*; FINDLAW.COM, <https://corporate.findlaw.com/business-operations/security-interests-in-investment-property.html> (Dec. 16, 2018).

⁴¹ UCC § 8-102(16).

⁴² Owen F. Walker, *Uniform Commercial Code Article 8 – Investment Securities*, 14 OHIO STATE LAW JOURNAL 57.

⁴³ UCC § 8-301.

filed December 20, 2018, that seeks to exempt cryptocurrencies from securities laws and regulations by preventing the “digital tokens” from being defined as securities.⁴⁴

V. How Can a Creditor Perfect its Interest in the Proceeds of Cryptocurrency?

Perfected security interests transfer to and attach to the proceeds of collateral for at least 20 days, and sometimes longer.⁴⁵ Because the perfection of security interests in cryptocurrencies will be accomplished through filing a financing statement, the perfected interest will attach to the proceeds of the cryptocurrency and remain longer than the 20-day time limit.⁴⁶

VI. Conclusion

Cryptocurrencies are volatile as there are currently no regulations and few opinions guiding the classification, sale, purchase, and investing of cryptocurrencies. If you are a lender seeking to use cryptocurrencies as collateral, be vigilant. Make sure you analyze the way the debtor is using the cryptocurrency and partake in a full analysis to determine whether the cryptocurrency will be categorized as a general intangible or security. Finally, make sure that any financing statement filed to perfect an interest in securities is sufficient, clearly describing the debtor, the secured party, and the collateral at interest.

⁴⁴ *US Lawmakers File Bill to Exempt Cryptocurrencies from Securities Laws*, COINDESK.COM, <https://www.coindesk.com/us-lawmakers-file-bill-to-exempt-cryptocurrencies-from-securities-laws?amp> (Dec. 20, 2018).

⁴⁵ UCC §§ 9-102(64), 9-315(e).

⁴⁶ UCC § 9-315(d); Jeanne L. Schroeder, *Bitcoin and the Uniform Commercial Code*, 24 MIAMI BUS. L. REV. 1, 30–32 (2016).



Blockchain, Cryptocurrency & Smart Contracts: Background, Use and Bankruptcy Implications

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www.gtlaw.com

Fun Facts About Cryptocurrency

- Cryptocurrency was developed by accident
 - The goal was to develop a decentralized cash system using encryption not cryptocurrency as we know it today.
 - Satoshi Nakamoto is credited with its development but no one knows who or what they are.
- There is a finite number of Bitcoins
 - 21 million
- In 2010 a programmer paid 10,000 Bitcoin for two pizzas
 - The value today is approximately \$35 million
- Crypto wallets – where coins can be stored - total around 8 million and counting
 - The largest Bitcoin wallet is owned by the FBI.

Risks in the Market

- Headlines on August 27, 2018 -- Bitcoin price crash / Bitcoin price sees massive gains and recovers / Bitcoin value increases \$400 in one hour / Bitcoin will disappear in a puff of smoke
- A hacker compromised a smart contract on the Ethereum network and stole 3.6 million ethers valued around 2.8 billion in today's dollars
- A self described "newbie" accidentally took control of more than 900,000 ether. Once the newbie discovered what he did, he tried to "undo" the transaction and accidentally destroyed approximately \$300 million of assets.
- Warren Buffet -- Bitcoin was nothing more than a "mirage and a bubble. . . the idea of Bitcoin having intrinsic value is a joke."
- Jamie Dimon, CEO of JPMorgan Chase, described Bitcoin as a "Fraud" and that it is worse than "tulip bulbs" . . . Bitcoin will not end well for retail and institutional investors.

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Law Firm Risks

- Laws Firms are on Notice
 - On Jan 22, 2018, SEC Chairman Clayton warned attorneys offering advice on ICOs that they may be breaching their professional obligation when they help facilitate ICOs. "Some lawyers are colluding with companies to sell securities without a license. . ."
- KYC concerns
 - Anonymity is a concern with banking regulations and anti-money laundering
- Data Privacy – by its nature blockchain technology is an open ledger for all to see – what is the impact on privacy laws?, e.g. EU-US privacy shield, GDPR, etc.
- Jurisdictional disputes – in smart contracts can parties identify the jurisdiction, governing law, venue? Are these enforceable?

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4

Actual & Developing Use Cases



Cryptocurrencies

- Smart contracts allow for transfer of digital assets
 - Cryptocurrencies / tokens are a form of smart contract
 - Fungible or non-fungible tokens
 - Security Tokens
 - Utility Tokens

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Actual & Developing Use Cases



Check Out:

- Mycelia
- BigchainDB
- JAAK

Music & Entertainment: content sharing

- Revenue for purchased creative works can be automatically distributed according to pre-determined licensing agreements.
- Provide trackable, verifiable record of ownership between artists & their works.
- Music rights holders/media owners can convert owned media, metadata & rights into “smart content” that can self-execute licensing transactions on the Ethereum blockchain.
- **Potential Blockchain Copyright Issues:** will there be enough space to store copyrighted works on the blockchain?

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Actual & Developing Use Cases



CES 2018
Kodak unveiled
KODAKCoin
Plans
Check Out:
kodakone.com

Photography: KODAKCoin

- Kodak plans to launch its own cryptocurrency: KODAKCoin.
- KODAKCoin will be backed up by a blockchain ledger and image rights platform KODAKOne that allows photographers to securely register new & old works.
- Still in development.
- Will use smart contracts to simplify payment to rights' owners (and ensure payment) when image is copied for use.

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Actual & Developing Use Cases



**Genesis of
Things**
➤ 3D printing
➤ Blockchain
➤ IoT-sensor
Technologies

3D Printing & Manufacturing :

- Digital files can be transmitted easily with click of a mouse.
- Parts and products are easier to share and track.
- Blockchain and smart contracts can help protect IP from theft and streamline project management and manufacturing.
- Lower the costs of 3D printing custom items.
- Help automate aspects of production and transactions.

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Actual & Developing Use Cases



Wills & Inheritance:

- Potential to make it easier to identify factual information on whether will is genuine & provide verifiable transaction data to dismiss meritless claims.
- Blockchain Tech. Corp. is developing a self-executing system with blockchain to automatically check the government's "Death Master file" maintained by the U.S. Soc. Security Office to verify death of individual.
- Pre-programmed rules set up the drafter of the will could automatically distribute assets to beneficiaries upon confirmation of death and eliminate the need for executors & court disputes.

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Actual & Developing Use Cases



Corporate Governance: Transparency in business accounting

- BoardRoom apparatus: provides governance framework and DApp platform so companies can manage smart contracts on public blockchains and permissioned Ethereum blockchains.
- DApp provides administrative system to ensure smart contracts are executed according to rules encoded on blockchain or to update rules.
- Can use the DApp for shareholder voting by proxy.

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Cryptocurrency: Use in Business

- Over 100,000 bitcoin transactions take place each day
- Not widespread acceptance, but a number of merchants have started to accept bitcoin as a form of payment:
 - Microsoft
 - Dell (started, but then stopped)
 - Dish Network (bitcoin and bitcoin cash)
 - Expedia (2014-2018)
 - Overstock (using Coinbase)
 - Subway (some franchisees)
 - Gap (gift cards through eGifter.com)
 - J.C. Penny (gift cards through eGifter.com)
 - Whole Foods (by purchasing gift card from Gyft)
- Merchants generally use bitcoin payment processors (e.g., Coinbase, Bitpay) to enable quick conversion to US dollars, and thereby avoid volatility risk
- Bitpay: “Cryptocurrency is an increasingly popular way for consumers to make purchases online as it reduces credit card fraud and is cheaper for the merchants.”

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Cryptocurrency and Smart Contracts in Bankruptcy

- Very few reported decisions, and not many issues addressed:
 - *Mt. Gox* (large bitcoin exchange company based in Japan): Chapter 15 case, main case commenced in Tokyo in 2014 and still pending; plan and valuation issues
 - *Hashfast Technologies LLC* (sold Bitcoin mining computers); addressed fraudulent transfer issue (bitcoin valued at time of transfer or recovery?)
 - *Giga Watt Inc* (bitcoin mining firm, filed in November 2018); ICO in May 2017 raised \$22M; sued for unregistered securities offering

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Cryptocurrency and Smart Contracts in Bankruptcy

- More bankruptcy cases on the horizon?
 - Crypto crash (from \$20k/bitcoin in 12/2017 to <\$3.5k/bitcoin in 1/2019) has reduced the price of bitcoin to less than the cost of mining
 - ETCDEV (startup that lead development of Ethereum Classic) decided to shutter operations in 12/2018
 - ConsenSys (crypto-related software startup) announced that it is reorganizing and reducing workforce by 13% [BoardRoom DApp project]
 - Crypto startups have been funded by venture capitalists and ICOs; free money likely to dry up with low valuation and bear market
- Lots of unanswered questions re: treatment as cash or cash collateral, Section 345(b) issues, adequate protection issues and plan issues

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Cryptocurrency as Property of the Estate

- Section 541 of the Bankruptcy Code broadly defines “property of the estate” as including “all legal or equitable interests of the debtor in property as of the commencement of the case”
- Cryptocurrency IS property of the estate; Debtor counsel needs to vet with client, identify any such assets and disclose on the bankruptcy schedules
- Debtor should maintain (or turnover to the trustee, as may be applicable) the private key to any virtual wallet
- Creditors or trustee could discover cryptocurrency through financial records, which may indicate the debtor cashing in or cashing out on an exchange platform
- Obtaining the “private key” is Key (*In re: Lawrence* for intransigent debtors?)
- Creditors or trustee may need to search for recipient of transfers; debtor could transfer cryptocurrency to someone outside court’s jurisdiction; limited ways to identify the owner or location of a cryptocurrency address

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Treatment of Cryptocurrency Assets

- Is cryptocurrency “money of the estate” for Section 345(b) or US Trustee Guideline purposes?
- Inconsistent treatment of cryptocurrency outside of bankruptcy as either currency or commodity (or something else)
- May depend on how Debtor uses cryptocurrency; does it hold cryptocurrency for investment or use it to purchase goods or services?
- Courts, creditors and US Trustee may not want Debtor to hold large amounts of cryptocurrency, because of huge volatility, transfer and hacking risk
- US Trustee may assert that it is “money of the estate” and needs to be converted to US dollars and maintained in a bank account consistent with Section 345(b) requirements
- If cryptocurrency is increasing in value, as it did in 2017, creditors may want to realize upside (*Mt. Gox* example)
- How does court or debtor balance need to protect assets of the estate v. potential desire of creditors to realize upside?

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Cryptocurrency as Cash Collateral?

- Section 363(a) provides: “In this section, “cash collateral” means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest”
- The term “other cash equivalents” is broad, and may encompass cryptocurrency
- Again, outcome could depend on how debtor uses cryptocurrency
- If cryptocurrency is “cash collateral,” the debtor must obtain consent or court authority under Section 363(c)(2) to use cryptocurrency
- How does debtor provide “adequate protection” of the secured creditor’s interest, given the volatile nature of cryptocurrency? Additional liens?
- If cryptocurrency is not “cash collateral,” debtor could use in the ordinary course under Section 363(c)(1)
- But secured creditor could still seek adequate protection under Section 363(e)

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Smart Contracts: How Smart Are They in Bankruptcy?

- As noted above, smart contracts self-execute upon fulfillment of conditions via triggers
- Raises potential issues post-filing regarding ability to stop payment on pre-petition smart contract obligations
- Potential Section 365 rejection issues; how to stop smart contract from executing
- How to determine and enforce damages when counter-party breaches?
- Quantifying damages under smart contracts also presents challenges:
 - Enforcement of monetary damages for distant and/or potentially anonymous entities
 - Choice of law
 - Lack of provisions regarding remedies
- Future solution; companion natural language contracts?

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Cryptocurrency and the End Game: the Plan

- What does debtor or trustee do with cryptocurrency assets for plan or distribution purposes
- If value is appreciating, creditors may want to realize upside
- But debtor is a fiduciary, and must maximize value of estate assets
- *Mt. Gox* example: 850,000 bitcoins stolen, but 202,000 found
 - 2014 value: ~\$500/bitcoin v. 2017 value of \$20,000/bitcoin
 - Even at 2019 values of ~\$3,500, a substantial increase
 - *Mt. Gox* creditors will benefit
- Could debtors structure plan with creditor option (take current value or hold for potential appreciation)?

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THE TREATMENT OF CRYPTOCURRENCIES IN BANKRUPTCY:
A LOT OF UNANSWERED QUESTIONS

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I. Introduction

Bitcoin has been on a rollercoaster ride over the last year, having lost a substantial amount of its value between December, 2017 and December, 2018.¹ This steep drop in value has led some prognosticators to deem that bitcoin will eventually become worthless.² It has also led to at least one bankruptcy filing. On November 19, 2018, Giga Watt, Inc., one of North America's largest cryptocurrency mining operations, filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Eastern District of Washington.³ Given the declining value of bitcoin and the high cost of operating mining operations, other cryptocurrency mining operations may follow suit.

While bitcoin has seen a drastic reduction in its value, as well as a drop in its commercial use over the last year,⁴ it is too early to write its obituary. In fact, some are predicting the bitcoin will rebound in 2019.⁵

The bottom line is that bitcoin and other cryptocurrencies will remain part of commercial transactions for the near future. What this means in the bankruptcy area is that bitcoin and other cryptocurrencies will be showing up as bankruptcy estate assets in future bankruptcy cases. As a result, bankruptcy judges and practitioners will be required to

¹ *Bitcoin has lost most its value this year*, The Economist, Nov. 29, 2018.

² Atulya Sarin, *Bitcoin is close to becoming worthless*, Marketwatch, Dec. 4, 2018.

³ *In re Giga Watt, Inc.*, No. 18-03197-FPC11 (Bankr. E.D. Wash. filed Nov. 19, 2018).

⁴ Olga Kharif, *Bitcoin's Use in Commerce Keeps Falling even as Volatility Eases*, Bloomberg, Aug. 1, 2018.

⁵ Panos Mourdoukoutas, *Bitcoin Will Regain Its Dominance In The Cryptocurrency Markets in 2019*, Forbes, Dec. 4, 2018.

determine how such cryptocurrencies in possession of a debtor upon filing should be treated for bankruptcy purposes, and what effect the treatment of such assets will have on the bankruptcy case.

II. Classification of Cryptocurrencies in Bankruptcy

Given the broad definition of “property of the estate,” as defined under section 541 of the Bankruptcy Code, which includes “all legal or equitable interest of the debtor in property as of the commencement of the case,” there is no question that cryptocurrencies will be considered property of the bankruptcy estate in the event of a bankruptcy filing. However, the bigger, and more important, unresolved question is how these cryptocurrencies will be classified for bankruptcy purposes. A bankruptcy court’s determination as to the classification of cryptocurrency assets may have a significant effect on how such assets are treated for bankruptcy purposes.

There are a few possibilities as to how a bankruptcy court could classify cryptocurrency assets:

A. Cryptocurrencies could be classified as “currency.”

One option for classification is that cryptocurrencies could be classified as “currency” for bankruptcy purposes.

The Bankruptcy Code does not define “currency.” However, currency is generally defined as “something, such as coins, treasury notes, and banknotes, that is in circulation as a medium of exchange.”⁶ Since bitcoins and other cryptocurrencies are currently being used commercially as a medium of exchange, such cryptocurrencies may fall under a broad reading of the definition of currency. This has been the position of a few courts

⁶ www.Merriam-Webster.com (definition of currency).

classifying cryptocurrencies outside of bankruptcy. In *SEC v. Shaver*, the District Court for the Eastern District of Texas found that bitcoin is a “currency or form of money.”⁷ In that case, the SEC brought suit against a perpetrator of a Ponzi scheme involving bitcoin. In reaching the conclusion that bitcoin is currency, the Court noted:

It is clear that Bitcoin can be used as money. It can be used to purchase goods or services, and as Shavers stated, used to pay for individual living expenses. The only limitation of Bitcoin is that it is limited to those places that accept it as currency. However, it can also be exchanged for conventional currencies, such as the U.S. dollar, Euro, Yen, and Yuan. Therefore, Bitcoin is a currency or form of money, and investors wishing to invest in BTCST provided an investment of money.

Id. Additionally, bitcoin has been held to be a currency for the purpose of money laundering statutes.⁸

However, in general commercial terms, “currency” has typically referred to money issued by a government and circulated within an economy.⁹ Since bitcoins and other cryptocurrencies are not issued by a government, they would not constitute “currency” as that term is generally used.

In the one bankruptcy case where a court was asked to determine whether bitcoin is a currency or commodity, the Bankruptcy Court for the Northern District of California, in the case of *Hashfast Tech. LLC v. Lowe (In re Hashfast Tech. LLC)*, declined to definitively rule on the question. However, the court appears to have implicitly found

⁷ *SEC v. Shavers*, No. 4:13-cv-416, 2013 WL 4028182 (E.D. Tex. Aug. 6, 2013).

⁸ See *United States v. Ulbricht*, 31 F. Supp.3d 540 (S.D. N.Y. 2014); see also *United States v. Budovsky*, No. 13cr368 (DLC), 2015 WL 5602853, at *10 (S.D. N.Y. Sept. 23, 2015) (noting under its regulations, the Treasury Department “does not differentiate between real currencies and convertible virtual currencies”); *United States v. Murgio*, 209 F. Supp. 3d 698, 707 (S.D. N.Y. 2016) (finding that bitcoins are funds because they can be accepted “as payment for goods and services” or bought “directly from an exchange with [a] bank account”).

⁹ www.investopedia.com (definition of currency).

bitcoin is not “currency,” stating that “bitcoin are not United States dollars.”¹⁰ Given that cryptocurrencies have not been adopted as the official money of any country and, as made clear in *Hashfast* that bitcoin is not the same thing as U.S. dollars, bankruptcy courts may not be inclined to find that cryptocurrencies constitute “currency” for bankruptcy purposes.

B. Cryptocurrency could be classified as a “commodity.”

Another possible classification of cryptocurrencies is that they are treated as commodities. This is the position taken by the U.S. Commodity Futures Trading Commission (CFTC), which, in 2014, declared virtual currencies to be a commodity subject to CFTC oversight under the Commodity Exchange Act.¹¹ The position of the CFTC that cybercurrencies are commodities subject to CFTC oversight has been upheld in at least two federal court decisions.¹²

In *Hashfast*, the bankruptcy court had the opportunity to determine whether bitcoin constituted a commodity for bankruptcy purposes. However, the court declined to make such a finding. Therefore, the question of whether a bankruptcy court may classify a cryptocurrency as a commodity for bankruptcy purposes remains an open question.

C. Cryptocurrencies could be classified as “general intangibles” under the UCC.

Bankruptcy courts could also determine that cryptocurrencies constitute “general intangibles” as defined under the Uniform Commercial Code (UCC). Article 9 of the

¹⁰ *HashFast Techs. v. Lowe (In re HashFast Techs. LLC)*, No. 14-30725DM, Adv. No. 15-03011DM (Bankr. N.D. Cal. Feb. 22, 2016).

¹¹ *CFTC Backgrounder an Oversight of and Approach to Virtual Futures Markets*, U.S. Commodity Futures Trading Commission, January 4, 2018, https://www.cftc.gov/sites/default/files/idc/groups/public/@customerprotection/documents/file/ba ckgrounder_virtualcurrency01.pdf.

¹² See *Commodity Futures Trading Comm’n v. McDonnell*, 287 F. Supp. 3d 213 (E.D. N.Y. 2018); *Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492 (D. Mass. 2018).

UCC defines a “general intangible” as “any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.”¹³ Since cryptocurrencies likely do not meet the other categories of personal property that are excluded from the definition of general intangibles, i.e. accounts, goods, instruments, etc., cryptocurrencies may fall under the UCC definition of “general intangibles.”

D. Cryptocurrencies could be classified as a “security.”

Bankruptcy courts could also classify cryptocurrencies as a “security.” The term “security” is defined under Section 3(a)(10) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as:

“any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.”¹⁴

¹³ UCC § 9-102(42).

¹⁴ 15 U.S.C. § 78c(a)(10).

Under the UCC, “security” is defined as “an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer.”¹⁵ By their nature, cryptocurrencies do not fit into any of the types of security listed in the Exchange Act definition (*e.g.*, notes, stock, bond, etc.), nor do cybercurrencies fit very well under the UCC definition of security, since cryptocurrencies do not involve the obligation or interest in an issuer. Given this, it seems less likely that a bankruptcy court would determine that cryptocurrencies constitute “securities”, under either the Exchange Act or the UCC, for purposes of classification in bankruptcy.

III. Impact of Classification of Cryptocurrency

A. Impact of Classification as Currency or Commodity

The classification of cryptocurrency as either currency or commodity could have a significant impact in a bankruptcy case. This impact is illustrated in the *Hashfast* case. In *Hashfast*, the bankruptcy trustee sought to avoid the transfer of bitcoin by the debtor to a third party as a preference and/or fraudulent conveyance. The trustee contended that the bitcoin was a commodity, such that the bankruptcy estate would be entitled to recover any increase in its value as of the date of recovery. The value of the bitcoin at stake in the case had increased substantially since the transfer, from \$363,000 to \$1.3 million. The defendant-transferee contended that bitcoin was currency, not a commodity, such that the value of transferred bitcoin recovered by the trustee should be determined at the time of transfer (\$363,000).¹⁶

¹⁵ UCC § 8-102(15).

¹⁶ *HashFast Techs. v. Lowe (In re HashFast Techs. LLC)*, No. 14-30725DM, Adv. No. 15-03011DM (Bankr. N.D. Cal. Feb. 22, 2016).

Therefore, for purposes of fraudulent transfers and preferences, the determination of whether a cryptocurrency is a currency versus a commodity can have a significant impact as to the value of the transfer that is sought to be avoided. Given the vast fluctuations in value of bitcoin, the positions of the trustee and transferee as to whether bitcoin is commodity or currency may switch sides, depending on the valuation of bitcoin at the time of transfer and/or time of recovery.

Additionally, if a cybercurrency is found to be “currency” for bankruptcy purposes, then any exchange agreements of bitcoin for cash as part of a transfer of bitcoin, may be considered “swap agreements,” as that term is defined under the Bankruptcy Code to include currency swaps.¹⁷ Transactions under swap agreements are granted greater protections in bankruptcy, with such transactions being exempt from the bankruptcy automatic stay provisions and from avoidance as a fraudulent transfer or preferential transfer.¹⁸ Therefore, if cryptocurrencies are deemed to be a currency, then a pre-

¹⁷ 11 U.S.C. § 101(53B).

¹⁸ 11 U.S.C. § 362(b)(17) provides that the automatic stay does not apply to the “exercise by a swap participant or financial participant of any contractual right (as defined in section 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements”. 11 U.S.C. § 546(g) provides that the “trustee may not avoid a transfer, made by or to (or for the benefit of) a swap participant or financial participant, in connection with any swap agreement and that is made before the commencement of the case, except under section 548(1)(A) of this title [, concerning the avoidance intentional fraudulent transfers]”. 11 U.S.C. § 560 provides that the “exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceedings under this title. As used in this section, the term ‘contractual right’ includes a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities

bankruptcy transfers of such cryptocurrencies may not be subject to avoidance as a fraudulent transfer or preference under the safe harbor provisions of section 546 of the Bankruptcy Code.

If a cryptocurrency is classified as a commodity, it may also qualify for similar protections against the applicability of the automatic stay and the right to avoid such transactions as fraudulent transfers or preferential transfers.¹⁹ However, to qualify for such protections as a commodity, then any agreement related to the transfer of bitcoins would have to constitute a “forward contract” as that term is defined under the Bankruptcy Code. By definition, “forward contracts” must have a maturity date that is more than two days after the date the contract is entered into.²⁰ Given the nature of bitcoins, it may be difficult for any transactions or agreements for the transfer of bitcoin to meet the definition of “forward contract.”

B. Impact of Classification of Cryptocurrency under UCC.

If classified as a general intangible under the UCC, cryptocurrencies may be subject to a properly perfected blanket lien held by secured creditor, which includes general intangibles. To the extent that such cryptocurrencies are used to purchase goods, then the cryptocurrency used in the purchase of such goods may remain subject to the secured creditor’s lien. Accordingly, the transferee may unknowingly receive the cryptocurrency subject to a secured parties’ lien. In the event of a default of the obligation to the secured

association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act) or in a resolution of the governing board thereof and a right, whether or not evidenced in writing, arising under common law, under law merchant, or by reason of normal business practice.”

¹⁹ *Id.*

²⁰ 11 U.S.C. § 101(25).

creditor, or a bankruptcy filing, significant issues may arise with the transferee of the cryptocurrency, as well as in the continued operations of a company using cryptocurrency to fund its business. Therefore, finding that cryptocurrencies are “general intangibles,” potentially subject to blanket liens of secured creditors, may limit the effective use of cryptocurrencies in commercial transactions. To the extent that cryptocurrencies are deemed to be a “security,” as defined under Article 8 of the Uniform Commercial Code, then the concern over a security interest continuing to attach to a cryptocurrency that is transferred in a commercial transaction may be less of a concern.²¹

IV. Conclusion

Given the volatility of bitcoins and other cryptocurrencies over the last year, the extent of the continued use cryptocurrencies in commercial transactions, and whether such use will increase or decrease over the next year, is an open question. However, given that commercial use of bitcoin has become more routine, as well as the many companies and individuals engaged in bitcoin mining, bankruptcy practitioners are likely to see bitcoins and other cryptocurrencies show up as bankruptcy assets on a more regular basis. Given the current lack of bankruptcy case law addressing cryptocurrencies, bankruptcy judges and attorneys should be considering how to address cryptocurrency assets, since this determination may have a significant impact on the bankruptcy case.

²¹ Bib Lawless, *Is UCC Article 8 Bitcoin's Savior (for Commercial Law)*, Credit Slips, Mar. 28, 2014.

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CRYPTOCURRENCIES IN BANKRUPTCY

January 30, 2019

Presented by: Rob Cox (Charlotte, NC)

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CRYPTOCURRENCIES IN BANKRUPTCY CASES? – it is just a matter of time.

- Giga Watt, Inc. – one of North America's largest bitcoin mining operations. Chapter 11 – November 19, 2018, E.D. Wash.
- Given the continued commercial use of cryptocurrencies, bankruptcy courts and practitioners are likely going to see cryptocurrencies as assets in their future bankruptcy cases

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Classification of Cryptocurrencies in Bankruptcy

- No real question that a cryptocurrency in possession of debtor at time of filing will be deemed property of the estate under Bankruptcy Code section 541.
- Larger, unanswered question is – how will such cryptocurrencies be classified for bankruptcy purposes?

3

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Cryptocurrencies could be classified as “currency.”

- *SEC v. Shavers* – Non-bankruptcy decision from ED of Texas involving a Ponzi scheme. Court found bitcoin is a “currency or form of money.”
- Also, bitcoin has been held by courts to be currency for purpose of money laundering statutes.
- **But see**, *Hashfast Tech. LLC v. Lowe (In re Hashfast Tech. LLC)* – Bankruptcy decision from ND of California. Court seemed to implicitly find that bitcoin was not currency, stating, “bitcoin are not United States dollars.”

4

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Cryptocurrencies could be classified as a “commodity.”

- Commodity Futures Trading Commission (CFTC), in 2014, declared virtual currencies to be a commodity subject to CFTC oversight under the Commodity Exchange Act. This position has been upheld in at least two non-bankruptcy court decisions.
- *Hashfast* – Court had opportunity to determine whether bitcoin constituted a commodity for bankruptcy purposes but declined to rule on the issue.

5

Bradley

Cryptocurrencies could be classified as a “security.”

- Cryptocurrencies do not fit well under the definition of “security” under Section 3(a)(10) of the Securities Exchange Act of 1934.
- Cryptocurrencies do not fit well under the definition of “security” under the Uniform Commercial Code.
- Classification of cryptocurrency under the *Howey Test*.

6

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Cryptocurrencies could be classified as “general intangibles” under the UCC.

- Article 9 defines a “general intangible” as “any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.”
- Since cryptocurrencies likely do not meet the other categories of personal property that are excluded from the definition of general intangibles, i.e. accounts, goods, instruments, etc., cryptocurrencies may fall under the definition of general intangible.

7

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Why does bankruptcy classification of cryptocurrency matter?

Avoidance of transfers of cryptocurrencies as fraudulent conveyances/preferences.

Hashfast: Involved bankruptcy trustee lawsuit to avoid transfer of bitcoin by the debtor to a third party as a preference and/or fraudulent conveyance.

* Trustee contended that the bitcoin was a commodity - entitled to recover any increase in its value as of the date of recovery.

* Transferee contended bitcoin was currency – value of transferred bitcoin determined at time of transfer.

The value of the bitcoin at stake in the case had increased substantially since the transfer, from \$363,000 to \$1.3 million. If commodity: Trustee recovery = \$1.3 million. If currency: Trustee recovery = \$363,000.

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Application of safe harbor provisions under Bankruptcy Code Section 546

- If cybercurrency found to be “currency” for bankruptcy purposes, then any exchange agreements of bitcoin for cash may be considered “swap agreements,” with such transactions being exempt from the bankruptcy automatic stay provisions and from avoidance as a fraudulent transfer/preference under section 546.
- If a cryptocurrency is classified as a commodity, it may also qualify for similar exemptions for the applicability of the automatic stay and avoidance as preference/fraudulent conveyances. However, to qualify for such protections as a commodity, the underlying agreement must constitute a “forward contract,” which, by definition, must have a maturity date that is more than two days after the date the contract is entered into. Given the nature of bitcoin, it may be difficult for any transactions or agreements for the transfer of bitcoin to meet the definition of “forward contract.”

Effect of Classification under UCC

- Cryptocurrencies as “general intangible.”
 - Blanket lien of secured party includes general intangibles.
 - Transfer of cryptocurrency subject to blanket lien.
 - May become a bigger issue in the event of an insolvency/bankruptcy.
- Cryptocurrency as “security.”
 - Concern over transfer being subject to lien less of a concern.

Questions?

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Thank you!

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