

# Will Bankruptcy Courts Treat Bitcoin as a Commodity?

Written By **Lance P. Martin** (lpm@wardandsmith.com)

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## What is virtual currency?

Is it money? Is it a commodity? Is it a hybrid of the two or something else entirely? The answer to the question has profound implications for lenders seeking to secure loans with virtual currency, and for parties in bankruptcy. In September 2018, the United States District Court for the District of Massachusetts ruled that virtual currency is a commodity under the Commodity Exchange Act ("CEA").

This ruling will not be the last word on how to characterize virtual currency. But lenders must heed the decision. If courts – particularly bankruptcy courts – follow this ruling, it will affect the rights of parties in bankruptcy, particularly on the valuation of claims and distributions to creditors.

The Massachusetts case involved a virtual currency called "My Big Coin" and an enforcement action against it by the Commodities Future Trading Commission ("CFTC"). The CFTC sued My Big Coin for engaging in a fraudulent "virtual currency scheme" that violated laws banning fraud or manipulation in the sale of a commodity. The CFTC alleged that My Big Coin induced customers to buy its virtual currency by making untrue and misleading statements, including that their currency was "backed by gold," would be accepted anywhere Mastercard was accepted, and was being "actively traded" on several currency exchanges. The CEA definition of commodity includes a list of agricultural products (e.g., wheat, cotton, butter, eggs) and "all other goods and articles ... and all services rights and interests ... in which contracts for future delivery are presently or in the future dealt in."

The Court determined that although there were no "contracts for future delivery" involving My Big Coin, there are "contracts for future delivery" in other virtual currencies – like Bitcoin. The Court found it was unnecessary for this specific item to underlie a futures contract. The CEA defines "commodity" generally and categorically, "not by type, grade, quality, brand, producer, manufacturer, or form." The focus is on classes or categories—not specific items—when determining whether the "dealt in" requirement is met. Because My Big Coin is within the virtual currency category, and because other virtual currencies are the subject of futures contracts, My Big Coin is a commodity.

In the bankruptcy context, the value of the debtor's assets is critical. With virtual currency, a fundamental question is when do you value it? Consider a fraudulent transfer claim. Before filing bankruptcy, the debtor transfers Bitcoin to a transferee. The transaction is deemed a fraudulent transfer. Must the transferee return the value of the Bitcoin on the transfer date? Or return the actual Bitcoins? If he no longer has the actual Bitcoins, does he deliver their value as of the date of return? With fraudulent transfers, if a transferee does not return property, the court can award its value, which is "measured at the time of recovery where the

property naturally increases in value.”

Given the price volatility of many virtual currencies, the valuation method could swing the value significantly. If Bitcoin, for example, is treated as an actual fiat currency (e.g., U.S. dollars), then probably it will be valued as of the date of the transfer. If the Debtor held Bitcoin as an asset, the value would be set as of the petition date. But if Bitcoin is treated as a commodity, then the transferee would have to return the actual Bitcoin or its value at return. In some bankruptcy contexts, commodities are valued "based on the price at which it could be purchased during the relevant period on the commodity market."

If bankruptcy courts treat virtual currency as a commodity – requiring return of the actual virtual currency – it may reduce the need for contested valuation litigation. This assumes the virtual currency can be returned. If it can't – whether because of an inability to access digital wallets, theft, or other reasons – then the valuation method will be paramount.

The volatility and intrinsically unique nature of virtual currency has created considerable confusion and uncertainty for lenders considering it as a new asset class for collateral. The My Big Coin decision provides some clarity on how virtual currency may be characterized and treated in court.

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