

**BITCOINS ARE NOT U.S. DOLLARS:
WHAT DOES THE RULING IN THE *HASHFAST* BANKRUPTCY MEAN?**

By Steven C. Reingold and Timothy J. Durken

Despite significant attention having been paid to the issue by the parties before it and by bitcoin community observers, the bankruptcy court in the *HashFast* case sidestepped the question of whether bitcoins are currency or commodities for purposes of the fraudulent transfer provisions of the Bankruptcy Code.¹ Bankruptcy Judge Dennis Montali of the U.S. Bankruptcy Court for the Northern District of California ruled that it was sufficient to decide that bitcoins are not U.S. dollars or the equivalent of U.S. dollars at the time of the alleged fraudulent transfers.

What's at stake? The Bankruptcy Code allows, with respect to avoided transfers, for the recovery of "the property transferred, or if the court so orders, the value of such property" under Section 550(a). In *HashFast*, the trustee brought an adversary proceeding to recover as fraudulent transfers payments made to a blogger identified as "Dr. Lowe," who promoted products for the debtors, totaling 3,000 bitcoins. At the time of the transfers, the bitcoins were worth \$363,861.43. The same bitcoins are worth approximately \$1.3 million today. If the court were to rule that the payment of bitcoins was a fraudulent transfer, what exactly is the trustee entitled to recover?

The trustee sought the entry of partial summary judgment, holding that the bitcoins constituted a commodity, not currency, and that if the transfers were avoided, the estate would be entitled to either the bitcoins or the value of the bitcoins as of the transfer date or the time of recovery, whichever is greater.

Dr. Lowe argued that the trustee was trying to have it both ways. He contended that bitcoin is a currency, that the bitcoins were the equivalent of U.S. dollars on the date of transfer and that they should therefore be valued as of that date. He pointed to the specific facts of the case, including that Dr. Lowe had endorsed the debtors' bitcoin mining hardware in return for 10% of the base sales price of the first 550 mining rigs.² The sale price was denominated in U.S. dollars of \$5,600 per unit (even though paid for primarily in bitcoins). Dr. Lowe earned a

¹ See Transcript of Hearing, *HashFast Technologies LLC and HashFast LLC v. Marc A. Lowe (In re HashFast Technologies LLC)*, Bankr. Case No. 14-30725DM, Adv. Pro. No. 15-3011DM (Bankr. N.D. Cal. Feb. 19, 2016) (Montali, B.J.) [Dkt. No. 48]; Order on Motion for Partial Summary Judgment (Feb. 23, 2016) [Dkt. No. 49].

² The amount of available bitcoin is finite and capped at 21 million (with approximately 15 million already in circulation today). Bitcoin miners use sophisticated and powerful computers to add transactions to the public ledger or "block chain" and are rewarded with newly mined bitcoins until all bitcoins have been released.

commission worth \$308,000 in U.S. dollars and was paid in bitcoins, pursuant to his agreement, in a series of payments made during September 2013. Dr. Lowe argued further that it was hypocritical for the trustee to seek to recover the current value of the bitcoins because the trustee took the contrary position with creditors who sought the return of bitcoins rather than the U.S. dollar value of the bitcoins at the time of the deposits or investments.³

The parties expended a great deal of effort briefing how various U.S. agencies (including the Internal Revenue Service, the Commodity Futures Trading Commission, the Securities and Exchange Commission, the Treasury Department's Financial Crimes Enforcement Network, and the Consumer Financial Protection Bureau) treat bitcoins as either currency or commodities.

At the hearing on the trustee's motion for partial summary judgment, Judge Montali explained that he was not going to make a "cutting edge ruling" and that it was unnecessary to decide whether bitcoins are currency for purposes of recovering a fraudulent transfer. It was, he stated, sufficient that bitcoins are not U.S. dollars. For example, if the defendant had been paid in euros rather than bitcoins, the Court would still have to decide whether the trustee was entitled to recover the amount of euros transferred or the value of the euros in U.S. dollars at the time of the transfer or the time of recovery.

The Bankruptcy Code's clawback actions are designed to return the bankruptcy estate to the financial position it would have enjoyed had the transfer not occurred. Who should get the benefit of the million dollars of post-transfer appreciation in the value of bitcoins—the estate or the transferee?

Judge Montali explained that it was premature to exercise the Court's discretion without a proper factual record and questioned the parties' attorneys about what factors should be taken into account in making that decision. In particular, he asked whether Dr. Lowe still holds the bitcoins or whether he sold them. It may be unfair to allow Dr. Lowe to retain a windfall if he still holds the bitcoins if they should be in the possession of the estate. On the other hand it may be unfair to charge Dr. Lowe with paying back the current value of the bitcoins if he sold them long ago at a lower market value. Judge Montali also noted that the bitcoin market could still collapse. In that scenario, the Court may require Dr. Lowe to pay to the estate the value of the bitcoins at the time of the transfer rather than the lower value at the time of recovery.

While Dr. Lowe lost in his effort to peg bitcoins automatically to their equivalent of U.S. dollars at the time of the transfer for purposes of recovery under Section 550(a) of the Bankruptcy Code, the *HashFast* Court's ruling is limited, and left open the question of whether the trustee would ultimately be entitled to recover the bitcoins or their value in U.S. dollars at the time of the transfer or recovery.

³ Judge Montali rejected this last argument, finding that it was entirely appropriate for the trustee to liquidate all of the debtors' assets and pay claims in U.S. currency.

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