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## In the Midst of Bankruptcy: How Cryptocurrency's Classification Affects Creditors Who Were Once Customers

Mia Qu

*University of Washington School of Law*

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# IN THE MIDST OF BANKRUPTCY: HOW CRYPTOCURRENCY’S CLASSIFICATION AFFECTS CREDITORS WHO WERE ONCE CUSTOMERS

Mia Qu\*

*Abstract:* In 2022, Congress proposed the Digital Commodities Consumer Protection Act to amend the Commodity Exchange Act and define a new type of commodity: digital commodity. The definition of digital commodity encompasses cryptocurrency and provides the Commodity Futures Trading Commission with jurisdiction over digital asset transactions. This definition of digital commodity has two important implications. First, it signals the lawmakers’ tendency to generalize cryptocurrency as a commodity. Second, it brings complications into how creditors—especially individual crypto account holders—can recover in the recent bankruptcy cases involving prominent crypto companies. This Comment contains four components. First, it provides a brief explanation of cryptocurrency and its underlying mechanism. Second, it reviews the debate over cryptocurrency’s classification as a commodity versus as a security. Third, it presents an overview of the bankruptcy system and the effect of a bankruptcy discharge. Finally, this Comment argues that generalizing cryptocurrency as a commodity limits the ability of creditors—especially cryptocurrency account holders, who are often individual consumers—to seek recovery outside of bankruptcy. This Comment aims to bring the interests of consumer creditors to the attention of judicial and legislative bodies.

## INTRODUCTION

“Cryptocurrency is a good idea on many levels,”<sup>1</sup> tweeted Elon Musk, “and we believe it has a promising future.”<sup>2</sup> At first, he was right. Cryptocurrency prices reached a peak in 2021 after a period of rapid growth since 2009.<sup>3</sup> Bitcoin, the most popular type of cryptocurrency, grew “from a mere idea to a legitimate currency” by mid-2014 and

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1. Elon Musk (@elonmusk), TWITTER (May 12, 2021), <https://twitter.com/elonmusk/status/1392602041025843203> [https://perma.cc/AS5Q-55FE].

2. *Id.*

3. David Yaffe-Bellany, Erin Griffith & Ephrat Livni, *Cryptocurrencies Melt Down in a ‘Perfect Storm’ of Fear and Panic*, N.Y. TIMES (May 12, 2022), <https://www.nytimes.com/2022/05/12/technology/cryptocurrencies-crash-bitcoin.html> (last visited Feb. 7, 2024); Lawrence J. Trautman & Alvin C. Harrell, *Bitcoin Versus Regulated Payment Systems: What Gives?*, 38 CARDOZO L. REV. 1041, 1055 (2017).

achieved a market capitalization of over a trillion dollars by late-2021.<sup>4</sup> Commentators have pointed out that the growth of the crypto market was, at least in part, an economic phenomenon enkindled by the coronavirus (COVID-19) pandemic as people flooded into digital asset investment during the lockdowns.<sup>5</sup> In 2022, sixteen percent of Americans owned some crypto, compared to only one percent back in 2015.<sup>6</sup> Since 2015, cryptocurrency has grown in popularity substantially.<sup>7</sup>

The year 2022 was unusual in many ways: the COVID-19 pandemic finally eased, yet inflation intensified,<sup>8</sup> and war broke out as Russia invaded Ukraine.<sup>9</sup> Things shifted in the world of crypto as well: the Digital Commodities Consumer Protection Act was introduced in the United States Senate<sup>10</sup> at a time when the cryptocurrency market had started to plummet.<sup>11</sup> The bill came after years of congressional concern over the cryptocurrency market's size and obscurity.<sup>12</sup> The technology running behind the scenes and the business models of crypto companies seem puzzling and inaccessible to the general public, yet the public is heavily involved in contributing capital to that market. Nevertheless, Congress's regulatory efforts might have arrived too late. In 2022, the

4. Trautman & Harrell, *supra* note 3, at 1055. As of November 2021, the top five crypto currencies ranked by market capitalization were: Bitcoin (\$1.08 trillion), Ethereum (\$509 billion), Binance Coin (\$102 billion), Tether (\$73 million), and Solana (\$61 million). See Historical Snapshot - 28 November 2021, COINMARKETCAP, <https://coinmarketcap.com/historical/20211128/> [<https://perma.cc/5GVR-4GZM>].

5. See Yaffe-Bellany et al., *supra* note 3.

6. See Andrew Perrin, *16% of Americans Say They Have Ever Invested in, Traded or Used Cryptocurrency*, PEW RSCH. CTR. (Nov. 11, 2021), <https://www.pewresearch.org/fact-tank/2021/11/11/16-of-americans-say-they-have-ever-invested-in-traded-or-used-cryptocurrency/> [<https://perma.cc/U45C-XHXY>].

7. See *id.*

8. See Gwynn Guilford, *Inflation Sits at 8.2% as Core Prices Hit Four-Decade High*, WALL ST. J. (Oct. 13, 2022, 6:42 PM ET), <https://www.wsj.com/articles/us-inflation-september-2022-consumer-price-index-11665628037> (last visited Feb. 7, 2024).

9. See Robert Pszczel, *The Consequences of Russia's Invasion of Ukraine for International Security – NATO and Beyond*, NATO REV. (July 7, 2022), <https://www.nato.int/docu/review/articles/2022/07/07/the-consequences-of-russias-invasion-of-ukraine-for-international-security-nato-and-beyond/index.html> [<https://perma.cc/Z6ZZ-KBGE>].

10. Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022).

11. See Douglas W. Arner, Dirk A. Zetsche, Ross P. Buckley & Jamieson Kirkwood, *The Financialization of Crypto: Lessons from FTX and the Crypto Winter of 2022-2023*, UNSW L. & JUST. RSCH. SERIES, 2023, at 1, 2, <https://www8.austlii.edu.au/au/journals/UNSWLRS/2023/31.pdf> [<https://perma.cc/2UHS-WK7X>].

12. See PAUL TIerno, CONG. RSCH. SERV., R47425, CRYPTOCURRENCY: SELECTED POLICY ISSUES 2 (2023) (“The rise of cryptocurrencies has produced a host of policy issues that may be of interest to Congress. In light of crypto’s various potential use cases and factions . . . , crypto has become a Rorschach test of sorts in which users and policymakers see in it what they value most and interpret policy considerations through that same lens.”).

growth of the crypto market not only stalled but headed into a meltdown, starting a “[c]rypto [w]inter.”<sup>13</sup>

The crypto market downturn was fueled by the crash of TerraUSD, a “stablecoin” that was marketed as having a more stable price as a digital asset.<sup>14</sup> Mechanically, stablecoins peg their value to a real-world “reference” asset, typically the U.S. dollar.<sup>15</sup> However, TerraUSD was not pegged to a real-world asset—instead, it was only algorithmically linked to another sister stablecoin.<sup>16</sup> In the beginning, TerraUSD gathered support from credible venture capital firms, which went on to fund projects built on TerraUSD with millions of real dollars.<sup>17</sup> Such investment created “a false sense of security” for people who might not otherwise understand cryptocurrency projects.<sup>18</sup> In mid-2022, the value of TerraUSD declined rapidly,<sup>19</sup> which drove the crypto market into a crisis as investors started panic-selling.<sup>20</sup> At around the same time, Coinbase, one of the largest cryptocurrency exchanges, “reported a \$430 million quarterly loss.”<sup>21</sup> Cryptocurrency companies started filing for bankruptcy

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13. See Arner et al., *supra* note 11, at 2.

14. Yaffe-Bellany et al., *supra* note 3.

15. See Garth Baughman, Francesca Carapella, Jacob Gerszten & David Mills, *The Stable in Stablecoins*, BD. OF GOVERNORS OF THE FED. RESRV. SYS. (Dec. 16, 2022), <https://www.federalreserve.gov/econres/notes/feds-notes/the-stable-in-stablecoins-20221216.html> [<https://perma.cc/383R-YVTS>].

16. Ryan Browne, *A \$3.5 Billion Bet on Bitcoin Becoming a ‘Reserve Currency’ for Crypto Is Being Put to the Test*, CNBC (May 10, 2022), <https://www.cnbc.com/2022/05/09/what-is-terrausd-ust-and-how-does-it-affect-bitcoin.html> [<https://perma.cc/7YUE-ZY6M>].

17. Yaffe-Bellany et al., *supra* note 3.

18. *Id.*

19. See Emily Nicolle, *Terra Collapse Triggers \$83 Billion Decentralized Finance Slump*, BLOOMBERG L. (May 24, 2022), <https://news.bloomberglaw.com/crypto/terra-collapse-triggers-83-billion-decentralized-finance-slump> (last visited Feb. 8, 2024) (“The collapse of one of decentralized finance’s most ambitious experiments has knocked more than \$83 billion off the sector’s total value, as investors fled for safer havens.”).

20. See Ryan Browne & MacKenzie Sigalos, *Bitcoin Investors Are Panicking as a Controversial Crypto Experiment Unravels*, CNBC (May 11, 2022), <https://www.cnbc.com/2022/05/10/bitcoin-btc-investors-panic-as-terrausd-ust-sinks-below-1-peg.html> [<https://perma.cc/RWC4-XFJ6>].

21. Yaffe-Bellany et al., *supra* note 3.

one after another, including a hedge fund,<sup>22</sup> a lender,<sup>23</sup> a broker,<sup>24</sup> and an exchange.<sup>25</sup>

While TerraUSD seems to be a special case, nourishing a “false sense of security”<sup>26</sup> is not uncommon in the crypto world. Consumers who do not have much knowledge about a company or digital currency often rely on the promise of security and devote their trust to a system without much transparency, only to have that trust broken ultimately. For example, Voyager, an app-based crypto broker company used for trading, swaps, and asset management, allegedly made false claims suggesting that the company was insured.<sup>27</sup> Consumers who invested in its cryptocurrency tokens would have their funds insured by the Federal Deposit Insurance Corporation against the company’s failure.<sup>28</sup> Then, in July 2022, Voyager filed for bankruptcy.<sup>29</sup> Before the filing, Voyager temporarily suspended all trading, deposits, and withdrawals. “This was a tremendously difficult decision,” the company announced, “but we believe it is the right one given current market conditions.”<sup>30</sup> Voyager later “estimated that it had

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22. See Kate Rooney & Alex Harring, *Founders of Bankrupt Three Arrows Capital Pitch New Platform for Crypto Debt Claims*, CNBC (Jan. 17, 2023), <https://www.cnbc.com/2023/01/16/founders-of-three-arrows-capital-pitch-platform-for-crypto-bankruptcy-claims.html> [<https://perma.cc/8FBW-3JXQ>].

23. See Wayne Duggan, *Celsius Crypto Meltdown: A Crypto Lender in Crisis*, FORBES ADVISOR (Oct. 4, 2022, 1:17 PM), <https://www.forbes.com/advisor/investing/cryptocurrency/what-is-celsius/> [<https://perma.cc/HH4Q-HWU9>].

24. Daniel Van Boom, *Crypto Crash Continues as Lender Voyager Digital Files for Bankruptcy*, CNET (July 6, 2022), <https://www.cnet.com/personal-finance/crypto/crypto-contagion-continues-as-lender-voyager-digital-files-for-bankruptcy/> [<https://perma.cc/DGG7-6C2K>].

25. Kalley Huang, *Why Did FTX Collapse? Here’s What to Know.*, N.Y. TIMES (Nov. 18, 2022), <https://www.nytimes.com/2022/11/10/technology/ftx-binance-crypto-explained.html> (last visited Jan. 5, 2024); Elizabeth Napolitano & Brian Cheung, *The FTX Collapse, Explained*, NBC NEWS (Nov. 18, 2022), <https://www.nbcnews.com/tech/crypto/sam-bankman-fried-crypto-ftx-collapse-explained-rcna57582> [<https://perma.cc/F6PG-B5FF>].

26. Yaffe-Bellany et al., *supra* note 3 (quoting Kathleen Breitman, co-founder of crypto platform Tezos).

27. See Letter from Elizabeth Warren, U.S. Senator, to Janet Yellen, Sec’y, U.S. Dep’t of Treasury 13–14 (Sept. 15, 2022) [hereinafter Letter from Elizabeth Warren], <https://www.warren.senate.gov/imo/media/doc/2022.09.15%20Letter%20to%20Treasury%20re%20Crypto%20Risks1.pdf> [<https://perma.cc/9HFH-FVP9>].

28. *Id.*

29. See Shivam Patel, Sinead Cruise & Tom Wilson, *Crypto Lender Voyager Digital Files for Bankruptcy*, REUTERS (July 6, 2022), <https://www.reuters.com/technology/crypto-lender-voyager-files-bankruptcy-2022-07-06/> (last visited Feb. 8, 2024).

30. Nelson Wang & CoinDesk, *Voyager Digital Freezes Withdrawals After Disclosing over \$500 Million Exposure to 3AC as Another Crypto Broker Staggers*, FORTUNE (July 1, 2022), <https://fortune.com/2022/07/01/voyager-digital-freezes-withdrawals-500-million-exposure-three-arrows-crypto-broker/> [<https://perma.cc/UQZ5-M59A>].

more than 100,000 creditors” and liabilities between one and ten billion dollars.<sup>31</sup>

Cryptocurrency companies plunged into bankruptcies one by one in 2022. In June 2022, Celsius, a large lender in the crypto space, “paus[ed]” all withdrawals and transfers between accounts “[d]ue to extreme market conditions.”<sup>32</sup> The company claimed to have acted in the interest of the crypto community.<sup>33</sup> Just one month later, Celsius filed for bankruptcy,<sup>34</sup> and the customer accounts remained frozen. The Celsius bankruptcy proceedings disclosed letters from crypto depositors, one of which read: “I am a . . . Celsius customer with my life savings on their platform. I am writing to inform you that I believe fraud has been committed by the Celsius Management Team.”<sup>35</sup> Then, in November 2022, FTX, one of the world’s largest cryptocurrency exchanges, filed for bankruptcy, too.<sup>36</sup> Commentators have described such action as crypto’s “Lehman moment.”<sup>37</sup> FTX had created its own digital coin called FTT and offered perks to attract individual crypto investors.<sup>38</sup> By the end of that November, the price of FTT dropped more than ninety percent.<sup>39</sup> In its bankruptcy filings, the company described a number of corporate missteps, including “the use of software to conceal the misuse of customer funds.”<sup>40</sup>

This series of bankruptcy filings demonstrates the risk and uncertainty of the crypto industry and has kindled heated discussions on its regulation. Because cryptocurrency is a creation of computational technology, it is difficult to define, classify, and regulate.<sup>41</sup> Cryptocurrency thus has long

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31. Patel et al., *supra* note 29.

32. Celsius, *A Memo to the Celsius Community* (June 12, 2022), <https://perma.cc/J6CR-R8DF>.

33. *Id.*

34. See Voluntary Petition for Non-Individuals Filing for Bankruptcy, *In re Celsius Network LLC*, No. 22-10964 (Bankr. S.D.N.Y. July 13, 2022).

35. Letter from Elizabeth Warren, *supra* note 27, at 16.

36. Alun John & Hannah Lang, *Crypto Exchange FTX Files for Bankruptcy as Wunderkind CEO Exits*, REUTERS (Nov. 11, 2022), <https://www.reuters.com/business/ftx-start-us-bankruptcy-proceedings-ceo-exit-2022-11-11/> (last visited Feb. 8, 2024).

37. Napolitano & Cheung, *supra* note 25. Lehman Brothers was a predominant finance company in the mortgage and investment banking industry. See Joe Hernandez, *How Lehman’s Collapse 15 Years Ago Changed the U.S. Mortgage Industry*, NPR (Sept. 15, 2023), <https://www.npr.org/2023/09/15/1199321274/lehman-brothers-collapse-2008-mortgages> [<https://perma.cc/F4MU-JL8K>]. It filed for bankruptcy in 2008 after the housing market collapse. See *id.* It was \$613 billion in debt, “sending the already recessionary economy into a tailspin.” *Id.*

38. See Huang, *supra* note 25; Napolitano & Cheung, *supra* note 25.

39. Huang, *supra* note 25.

40. Declaration of John J. Ray III in Support of Chapter 11 Petitions and First Day Pleadings at 23, *In re FTX Trading Ltd.*, No. 22-11068 (JTD) (Bankr. D. Del. Nov. 17, 2022).

41. See *infra* section I.B.

puzzled practitioners as well as lawmakers, and a major debate exists about whether it should be treated as a commodity or a security.<sup>42</sup>

In the bankruptcy arena, the classification matters to individuals who once held crypto accounts and are still owed money. Many crypto account holders are ordinary consumers<sup>43</sup> who have little understanding of bankruptcy proceedings. How virtual tokens and coins are defined ultimately affects their status as creditor in terms of how much money they can get back and how soon.<sup>44</sup> A legally sound classification also matters for administrative reasons. If cryptocurrencies are classified as *securities*, they are subject to existing securities regulations, and the Securities and Exchange Commission (SEC) has primary regulatory authority.<sup>45</sup> If they are classified as *commodities*, the Commodities and Futures Trading Commission (CFTC) has jurisdiction.<sup>46</sup>

At a higher level, this Comment urges the bankruptcy courts and legislative bodies to recognize the interests of crypto account holders who are creditors and individual consumers. Specifically, this Comment examines how cryptocurrency's classification matters to debt dischargeability. Part I provides a brief discussion of the evolution of cryptocurrency and offers a brief explanation of the technology behind it. Part II reviews cryptocurrency's classification debate involving two regulatory agencies: the Commodity Futures Trading Commission and the Security Exchanges Commission. Part III introduces the bankruptcy system and its proceedings, focusing on the creditors' involvement in the process and the treatment of their claims. Part IV then analyzes why the classification of cryptocurrency matters in bankruptcy proceedings involving individuals who held crypto accounts.

The classification of cryptocurrencies affects how crypto account holders can recover their assets.<sup>47</sup> Generalizing cryptocurrencies as commodities closes the door for individual creditors to seek a non-

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42. See, e.g., Cheryl L. Isaac, Keri E. Riemer, Christine Mikhael & Stephen M. Humenik, *CFTC and SEC Perspectives on Cryptocurrency and Digital Assets – Volume I: A Jurisdictional Overview*, K&L GATES (May 6, 2022), <https://www.klgates.com/CFTC-and-SEC-Perspectives-on-Cryptocurrency-and-Digital-Assets-Volume-I-A-Jurisdictional-Overview-5-6-2022> [https://perma.cc/GK8M-PWP6] (analyzing which agency has jurisdiction to regulate cryptocurrency).

43. Jordan McKee, *Consumers View Cryptocurrency As An Asset, Not A Payment Method...For Now*, FORBES (May 10, 2022), <https://www.forbes.com/sites/jordanmckee/2022/05/10/consumers-view-cryptocurrency-as-an-asset-not-a-payment-method-for-now/?sh=7b97fdad4e85> [https://perma.cc/8AJD-FQ83] (reporting that consumers use cryptocurrency as a general investment).

44. See *infra* section III.B.

45. Isaac et al., *supra* note 42.

46. *Id.*

47. See *infra* Part IV.

discharge for their debt, thus foreclosing their opportunities to keep seeking payments after bankruptcy. The interests of individual consumers as creditors deserve careful consideration both judicially and legislatively.

## I. THE IDEA OF CRYPTOCURRENCY

What is cryptocurrency? Why does it pose regulatory challenges? The following sections explain the origin and mechanism of cryptocurrency. It is necessary to understand what the word “cryptocurrency” implies before discussing its characterization.

### A. *The Origin*

Money is not required to take a certain form. It exists to serve a transactional role as a medium of exchange.<sup>48</sup> The early form of money often relied on a commodity with some intrinsic value, such as gold or silver.<sup>49</sup> Gradually, commodity-backed money became more portable and was replaced by fiat money that is akin to banknotes: gold coins became gold certificates.<sup>50</sup> When the invention of the internet and connected computing platforms made it possible to avoid transporting paper money, people accepted measures such as online transfers to move money from one point to another without ever being in anyone’s hands.<sup>51</sup> Digital currency thus became a phenomenon because of the dramatic and influential technological advances that fundamentally shifted our society.<sup>52</sup>

Those technological advances eventually gave birth to cryptocurrency, a general term referring to digital assets that vary in their fungibility.<sup>53</sup>

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48. Joseph M. Ostroy & Ross M. Starr, *The Transactions Role of Money*, in 1 HANDBOOK OF MONETARY ECONOMICS 4–5 (Benjamin M. Friedman & F. H. Hahn ed., 1990).

49. Benton E. Gup, *What Is Money? From Commodities to Virtual Currencies/Bitcoin*, in THE MOST IMPORTANT CONCEPTS IN FINANCE 1 (Benton E. Gup ed., 2017).

50. *Id.*

51. See Robert DeYoung, *The Internet’s Place in the Banking Industry*, FED. RESRV. BANK OF CHI., <https://www.chicagofed.org/publications/chicago-fed-letter/2001/march-163> [https://perma.cc/XV52-56JT] (“Internet banking gives customers the ability to access virtually any type of banking service (the main exception for now being cash) in any place and at any time.”).

52. See Trautman & Harrell, *supra* note 3, at 1049 (“[I]t’s important to remember that money is nothing but a virtual commodity. . . . Major changes in portable, connected, and secure computing platforms will eventually allow money to move from physical to virtual form.” (quoting *The Future of Electronic Payments: Roadblocks and Emerging Practices: Hearing Before the Subcomm. on Domestic & Int’l Monetary Pol’y of the H. Comm. on Banking and Fin. Servs.*, 106th Cong. 11 (2000) (statement of James Van Dyke, Senior Analyst, Jupiter Communications))).

53. See Jonathan D. Bick, *NFTs, Cryptocurrencies, and Crypto Assets Explained*, BRACH EICHLER LLC, <https://www.bracheichler.com/insights/nfts-cryptocurrencies-and-crypto-assets->



What differentiates cryptocurrency from the traditional forms of money is not only the technology behind cryptocurrency but also the idea of a decentralized monetary system.<sup>54</sup> There is no single entity—such as a bank—that monitors transactions or a government that can assert control.<sup>55</sup> For example, one of the most well-known cryptocurrencies, Bitcoin, was “portrayed as a decentralized alternative to the traditional financial system” where proponents could conduct transactions among themselves in a reliable way.<sup>56</sup> “A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution.”<sup>57</sup> As of July 2016, the market capitalization of Bitcoin in circulation aggregated to about \$6 billion,<sup>58</sup> and Bitcoin was only one of more than 600 different kinds of cryptocurrencies worth a total of approximately \$13.011 billion.<sup>59</sup> Prominent public figures, including Elon Musk and Jack Dorsey, embraced cryptocurrency and further moved it into the mainstream.<sup>60</sup> The celebrity endorsements contributed to cryptocurrency’s public recognition and consensus on its value to be used for exchange, and the crypto market’s growth was fueled by increased societal acceptance.<sup>61</sup> Concerned with the development of digital assets, President Biden issued Executive Order 14067 in March 2022, stating that:

In November 2021, non-state issued digital assets reached a combined market capitalization of \$3 trillion . . . [G]rowing development and adoption of digital assets and related

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explained/ [https://perma.cc/KJU9-LWHV] (explaining fungible and non-fungible tokens); *see also* Joe Cortez, *Fungible: What the ‘F’ in NFT Stands for and Why It Matters*, BUS. INSIDER (Oct. 25, 2021), <https://perma.cc/5V56-66AN> (explaining the idea of fungibility).

54. *See infra* section I.B.

55. *See infra* section I.B.

56. Yaffe-Bellany et al., *supra* note 3.

57. SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM 1, <https://bitcoin.org/bitcoin.pdf> [https://perma.cc/B6BW-F8BV]. Nakamoto’s paper is known as the “Bitcoin Whitepaper.” *Bitcoin Glossary: 2018 Annual National Seminar*, U.S. SENT’G COMM’N (2018), [https://www.ussc.gov/sites/default/files/pdf/training/annual-national-training-seminar/2018-materials/emerging-tech\\_glossary-crypto.pdf](https://www.ussc.gov/sites/default/files/pdf/training/annual-national-training-seminar/2018-materials/emerging-tech_glossary-crypto.pdf) [https://perma.cc/7RNB-T62L].

58. Trautman & Harrell, *supra* note 3, at 1055.

59. *Id.* at 1053.

60. Yaffe-Bellany et al., *supra* note 3.

61. *See, e.g.*, Roshni Parikh, *Impact of Celebrity Endorsed Cryptocurrency*, B.U. SCH. L. REV. BANKING & FIN. L. (May 17, 2023), <https://www.bu.edu/rbfl/2023/05/17/impact-of-celebrity-endorsed-cryptocurrency/> [https://perma.cc/CJ8E-XG8N] (arguing that celebrity endorsements revealed gaps in the current regulation of crypto); Darryn Pollock, *Cryptocurrencies Need to Become as Socially Acceptable as Social Media*, FORBES (Mar. 4, 2019), <https://www.forbes.com/sites/darrynpollock/2019/03/04/cryptocurrencies-need-to-become-as-socially-acceptable-as-social-media/?sh=6a012bb35171> [https://perma.cc/XTK7-GDJH] (showing what the growth of cryptocurrency can learn from the rise of social media).

innovations, as well as inconsistent controls to defend against certain key risks, necessitate an evolution and alignment of the United States Government approach to digital assets.<sup>62</sup>

Cryptocurrency's technological novelty does not change its nature as a monetary exchange system that relies on the trust and confidence of its users.<sup>63</sup> "The money we have in our pockets is no more and no less than a symbol of a trusted system that works."<sup>64</sup> As perplexing as it is, cryptocurrency's prosperity relies on a sense of security in an industry that is largely mysterious to common investors.<sup>65</sup> It is often mentioned that crypto is inseparable from the technology called blockchain.<sup>66</sup> The following section thus explores the mechanism of blockchain.

### B. *The Mechanism*

Cryptocurrency relies on a peer-to-peer, distributed ledger network.<sup>67</sup> Instead of depending on centralized authorities like banks to confirm and manage transactions between market participants, the network as a whole is involved in validating transactions using the blockchain technology.<sup>68</sup> Such validations are necessary because certain functions of a financial system are still required, albeit not centralized, in order for any currency to be useful.<sup>69</sup> For example, necessary functions may include keeping a

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62. Ensuring Responsible Development of Digital Assets, Exec. Order No. 14067, 87 Fed. Reg. 14143 (Mar. 9, 2022).

63. See Primavera De Filippi, Morshed Mannan & Wessel Reijers, *Blockchain as a Confidence Machine: The Problem of Trust & Challenges of Governance*, TECH. SOC'Y, Aug. 2020, at 1.

64. See Trautman & Harrell, *supra* note 3, at 1050 (quoting *The Future of Electronic Payments*, *supra* note 52, at 5 (statement of Thomas P. Vartanian, Chairman of Electronic Commerce and Financial Services Transactions Group, Fried, Frank, Harris, Shriver & Jacobson, Washington, D.C.)).

65. See Joshua Davis, *The Crypto-Currency*, NEW YORKER (Oct. 3, 2011), <https://www.newyorker.com/magazine/2011/10/10/the-crypto-currency> (last visited Feb. 7, 2024) ("Bitcoin, in other words, survives because of what you can see and what you can't. Users are hidden, but transactions are exposed. The code is visible to all, but its origins are mysterious. The currency is both real and elusive . . .").

66. See *infra* section I.B.

67. See MARK FENWICK & ERIK P.M. VERMEULEN, A PRIMER ON BLOCKCHAIN, SMART CONTRACTS & CRYPTO-ASSETS 3 (2019).

68. David Lucking & Vinod Aravind, *Cryptocurrency as a Commodity: The CFTC's Regulatory Framework*, in GLOBAL LEGAL INSIGHTS - FINTECH 2, 2 (Barbara Stettner & Bill Satchell eds., 2019).

69. See *Financial Development*, THE WORLD BANK, <https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-development> [<https://perma.cc/8UUC-J99R>] ("The five key functions of a financial system are: (i) producing information ex ante about possible investments and allocate capital; (ii) monitoring investments and exerting corporate governance after providing finance; (iii) facilitating the trading, diversification, and management of risk; (iv) mobilizing and pooling savings; and (v) easing the exchange of goods and services.").

record of how many assets are in someone's account, how much they have transferred, and how much they have received. How such validations are done, then, involves a critical concept: the distributed ledger technology.

Consider the creation of a normal public ledger that records all financial transactions occurring in a network, where participants in that network can view and modify the ledger.<sup>70</sup> A decentralized financial system is achievable as long as everyone honestly and diligently records every transaction.<sup>71</sup> Nevertheless, the trustworthiness of such a public ledger is concerning because anyone can claim that a transaction has occurred and add a line in the ledger.<sup>72</sup> The ledger is likely to become unreliable.<sup>73</sup> A decentralized or distributed public ledger intends to solve this problem. It rejects false information recording—thus ensuring information security—without the need for a third party to monitor and confirm its transitional validity.<sup>74</sup> What if every participant in the same network has their own copy of the ledger and must come to a consensus as to what transactions actually occurred in the network? With this distributed public ledger system, the participants do not even have to trust each other as long as they can trust the system—that every transaction occurring in the network is broadcasted to every network participant accurately, so the individual ledgers can maintain the most up-to-date record.<sup>75</sup> It would be very difficult to add a line out of thin air in every network participant's ledger. In this sense, the system participants themselves vouch for the record's legitimacy and act to store the transactional data instead of a third party.<sup>76</sup>

Blockchain technology adds another layer of security to this idea by bringing computing power into the picture. The distributed public ledger idea alone still faces some issues. It is still possible for someone who has

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70. This is the set-up of the “Byzantine Generals Problem” in computer science. See Leslie Lamport, Robert Shostak & Marshall Pease, *The Byzantine Generals Problem*, 4 ACM TRANSACTIONS ON PROGRAMMING LANGUAGES & SYS. 382, 382–84 (1982).

71. Cf. *id.* (showing that the Byzantine Generals Problem involves a group of army generals who must agree on a plan of action).

72. Cf. *id.* (showing how the Byzantine Generals Problem is challenging because it involves generals who may be traitors).

73. The central issue is that there is no authority or intermediary to verify that a transaction is plausible. Cf. *id.* (explaining how the Byzantine Generals Problem aims to resolve the issue of untrustworthy generals trying to prevent an agreement on a plan of action).

74. Trevor I. Kiviat, Note, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 DUKE L.J. 569, 574 (2015).

75. *Id.* at 578.

76. This is the underlying idea of a “decentralized consensus mechanism” and the reason why sometimes the decentralized public ledgers are known as a “trustless” system. See Kelsey Bolin, Note, *Decentralized Public Ledger Systems and Securities Law: New Applications of Blockchain Technology and the Revitalization of the Sections 11 and 12(A)(2) of the Securities Act of 1933*, 95 WASH. U. L. REV. 955, 958 (2018).

access to the network to broadcast a series of false transactions.<sup>77</sup> The question then becomes: how does an individual participant who receives a network broadcast determine whether the transfer is valid? Blockchain technology answers this question through a “probabilistic approach” by making it computationally infeasible for the network disturbers to maintain a blockchain where false information exists.<sup>78</sup> The technology does so through cryptographic algorithms—thus the name “crypto”—a “proof-of-work” validation system and a consensus mechanism.<sup>79</sup>

Instead of going into the individual ledgers directly, transactions occurring within the same network are gathered into a locked “block.”<sup>80</sup> The block is then broadcasted to the network, and each individual ledger records the block.<sup>81</sup> Thus, a transaction must first be included in a block to have the possibility of being recorded by every individual ledger within the network and gain validity.<sup>82</sup> Additionally, a block must indeed be recorded by each individual ledger.<sup>83</sup> The lock can be thought as a computer puzzle solvable only by random guessing—the lock is so complex and impenetrable that it is nearly impossible to open it but by trying every possible key.<sup>84</sup> When a system participant finds the right key, other system participants can then verify if the key indeed opens the lock easily.<sup>85</sup> In other words, they can “validate” the transactions contained in the block and include the transactions in their own records.<sup>86</sup> The unlocked block itself is added to a “chain” by identifying the previous block that was opened and the next block to be opened, so as a whole, the blockchain contains all past transactions that have been validated.<sup>87</sup>

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77. See *id.* at 959 (explaining how blockchain technology prevents “[p]otential attackers attempting to flood a ledger with false information, either by entering completely falsified data or by entering valid transactions multiple times”).

78. See *id.*

79. Kiviat, *supra* note 74, at 578–79.

80. See Lawrence J. Trautman & Mason J. Molesky, *A Primer for Blockchain*, 88 UMKC L. REV. 239, 243 (2019).

81. See Kiviat, *supra* note 74, at 578; see also Trautman & Molesky, *supra* note 80, at 244 explaining how “currency transfer occurs in a completely decentralized fashion” and requires participation by the “nodes in the bitcoin network”).

82. See Trautman & Molesky, *supra* note 80, at 242–43.

83. See Bolin, *supra* note 76, at 960–61 (explaining how each transactional block comes with a complex mathematical problem, and “[w]hen the problems are solved, the transactional block is validated and added to the chain”). The concept of a “lock” here is a metaphor to the complex mathematical problem.

84. See Trautman & Molesky, *supra* note 80, at 242–46.

85. Kiviat, *supra* note 74, at 579–80.

86. *Id.* at 579.

87. See Trautman & Molesky, *supra* note 80, at 243.

This blockchain system ensures a few outcomes. The more people validate the key, the more impossible it becomes for someone to change a past transaction after the fact, because they would have to modify the record of everyone who recorded the block.<sup>88</sup> The computational puzzle lock also makes it very difficult to record false transactions because of a consensus mechanism, where it is nearly impossible for the chain containing the false block to be recognized by network participants as containing valid transactions.<sup>89</sup>

How, then, does cryptocurrency come into play? Bitcoin, for example, represents how blockchain technology incentivizes network participants to discover and obtain superior computational power to solve the block the fastest.<sup>90</sup> Because the key is practically found through random guessing, the more guesses a computer can make in a given time, the faster it can find the key.<sup>91</sup> The first puzzle-solver to find the key—known as the “miner”<sup>92</sup>—is rewarded with a certain number of Bitcoin.<sup>93</sup> Those newly mined Bitcoin can then be exchanged or used to obtain goods and services at places that accept them.<sup>94</sup> Based on this understanding, cryptocurrencies—in forms of digital tokens—are arbitrary creations that symbolize a successful validation process of financial transactions. They do not have a physical form or a set unit of value but serve as a storage of value based on how much the purchasers think they are worth.<sup>95</sup> Blockchain technology is used to provide network-secured data and value storage.

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88. See Kiviat, *supra* note 74, at 578–79.

89. When there are two blockchains containing conflicting information, the longer chain has the network’s consensus to be the valid chain. Trautman & Molesky, *supra* note 80, at 245. For a more detailed explanation, see *id.* at 243–46.

90. Kiviat, *supra* note 74, at 579 (“Users are incentivized to bear the computational costs of validation because successful participants are rewarded with new bitcoin.”).

91. Trautman & Molesky, *supra* note 80, at 242–46.

92. See Kiviat, *supra* note 74, at 591; see also *id.* at 579 (explaining that users who “bear the computational costs of validation” are said to have “mined” the Bitcoin “analogous[ly] to gold miners expending resources to add gold to circulation”).

93. See JOSHUA A. KROLL, IAN C. DAVEY & EDWARD W. FELTEN, *THE ECONOMICS OF BITCOIN MINING, OR BITCOIN IN THE PRESENCE OF ADVERSARIES* 5–6 (2013), <https://www.utwente.nl/en/ces/sal/exams/Blockchain-and-Distributed-Ledger-Technology-test/1-Bitcoin/bitcoin-in-the-presence-of-adversaries.pdf> [<https://perma.cc/RL66-JNHA>].

94. See Eric Engle, *Is Bitcoin Rat Poison?: Cryptocurrency, Crime, and Counterfeiting (CCC)*, 16 J. HIGH TECH. L. 340, 342 n.5 (2016).

95. See Dirk G. Baur & Thomas Dimpfl, *The Volatility of Bitcoin and Its Role as a Medium of Exchange and a Store of Value*, 61 EMPIRICAL ECON. 2663, 2678–79 (2021); Max Kubát, *Virtual Currency Bitcoin in the Scope of Money Definition and Store of Value*, 30 PROCEDIA ECON. & FIN. 409, 410–13 (2015); *Goldman Sachs Says Bitcoin Will Compete with Gold as “Store of Value,”* REUTERS (Jan. 5, 2022), <https://www.reuters.com/business/finance/goldman-sachs-says-bitcoin-will-compete-with-gold-store-value-2022-01-05/> (last visited Feb. 8, 2024).

Not all cryptocurrencies are created the same, however. For example, the algorithmic puzzle-solving process is not always required for tokens offered from Initial Coin Offerings (ICOs), an emerging venture capital financing method.<sup>96</sup> An entrepreneur can issue tokens in a “pre-sale” to raise funds for the company, promising that the tokens will be a medium of exchange in the crypto network and will rise in value as an investment.<sup>97</sup> In its nature, an ICO is similar to a more common capital-raising method called Initial Public Offering: both involve issuing assets that are tradeable and can potentially generate a return.<sup>98</sup> The characteristics of ICOs and regulatory concerns have been subject to much debate among scholars and policymakers.<sup>99</sup>

The blockchain technology that gave birth to cryptocurrency is far from intuitive. In fact, the term “cryptocurrency” itself is a gross generalization of different types of digital tokens serving different purposes.<sup>100</sup> Naturally, disagreements arise as to cryptocurrencies’ legal classification and regulatory treatment. The next Part of this Comment intends to introduce a major debate in determining crypto’s legal status.

## II. THE DEBATE ON CRYPTOCURRENCY CLASSIFICATION

Cryptocurrency’s characterization and regulation have been hotly debated among practitioners and scholars alike.<sup>101</sup> Because cryptocurrency is tied to an algorithmic computational network and can serve as a form of investment or a medium of exchange,<sup>102</sup> it may be

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96. See, e.g., Randolph A. Robinson II, *The New Digital Wild West: Regulating the Explosion of Initial Coin Offerings*, 85 TENN. L. REV. 897, 924–27 (2018) (comparing ICOs to initial public offerings, “the process through which companies sell stock shares to the public for the first time,” where tokens are sold without involving the blockchain mechanism).

97. Sabrina Howell, Marina Niessner & David Yermack, *Initial Coin Offerings: Financing Growth with Cryptocurrency Token Sales* 13 (Eur. Corp. Governance Inst., Working Paper No. 564/2018, 2019).

98. Anna Wiśniewska, *The Initial Coin Offering – Challenges and Opportunities*, 7 COPENICAN J. FIN. & ACCT. 99, 103 (2018).

99. *Id.*

100. See Coryanne Hicks, *Different Types of Cryptocurrencies*, FORBES (Mar. 15, 2023), <https://www.forbes.com/advisor/investing/cryptocurrency/different-types-of-cryptocurrencies/> [https://perma.cc/N5RB-RAG9].

101. See, e.g., Evan Hewitt, *Bringing Continuity to Cryptocurrency: Commercial Law as a Guide to the Asset Categorization of Bitcoin*, 39 SEATTLE U. L. REV. 619, 636–639 (2016) (summarizing issues related to Bitcoin’s asset classification, including the attachment of a security interest to Bitcoin and its capital gains calculation); Tara Mandjee, *Bitcoin, Its Legal Classification and Its Regulatory Framework*, 15 J. BUS. & SEC. L. 157, 181–83 (2015) (discussing how bitcoin should be regulated).

102. See *supra* section I.B.

characterized as a general intangible asset,<sup>103</sup> a security,<sup>104</sup> a currency,<sup>105</sup> or a commodity.<sup>106</sup> In the bankruptcy arena, the debate over whether cryptocurrency should be considered a commodity or a currency has received some attention, because such differentiation has a significant impact on valuing a debtor's assets.<sup>107</sup> However, the debate on whether cryptocurrency should be considered as a type of securities and its relevance to bankruptcy proceedings has received surprisingly little attention. The following subsections examine the classification of crypto through three lenses: as a commodity, as a security, and as a subject of legislative efforts.

## A. *The CFTC's Authorities to Regulate Cryptocurrency as a Commodity*

### 1. *The U.S. Commodity Futures Trading Commission*

If cryptocurrency is considered a commodity, its regulation would fall under the jurisdiction of the U.S. Commodity Futures Trading Commission (CFTC). The CFTC has exclusive jurisdiction to regulate all "commodit[ies]," as defined under the Commodity Exchange Act of 1936 (CEA),<sup>108</sup> and exclusive jurisdiction over "transactions

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103. See, e.g., Scott Muir, *Executive Summary: Accounting for Crypto Assets*, KPMG (Mar. 2022), <https://perma.cc/WQC9-NRDJ> (providing a summary of the accounting for crypto assets).

104. See, e.g., *Framework for "Investment Contract" Analysis of Digital Assets*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> [<https://perma.cc/5EM9-CQDX>] (last modified Mar. 8 2023) (considering characteristics of virtual currency that behave similarly to real currency).

105. E.g., Reuben Grinberg, *Bitcoin: An Innovative Alternative Digital Currency*, 4 HASTINGS SCI. & TECH. L.J. 159, 160–61 (2012).

106. E.g., Marc Gronwald, *Is Bitcoin a Commodity? On Price Jumps, Demand Shocks, and Certainty of Supply*, 97 J. INT'L MONEY & FIN. 86 (2019).

107. For example, in *In re Hashfast Techs., LLC*, No. 3:14-BK-30725, 2016 WL 8460756 (Bankr. N.D. Cal. 2014), the defendant paid another person using Bitcoin before filing for bankruptcy, and the trustee sought to avoid the payment as a fraudulent transfer. Megan McDermott, Essay, *The Crypto Quandary: Is Bankruptcy Ready?*, 115 NW. U. L. REV. 1921, 1929–30 (2021). This case was a missed opportunity for the bankruptcy courts to address the classification of cryptocurrency. When the payment was made, the total value of the Bitcoin was approximately \$300,000. *Id.* When the defendant filed for bankruptcy, the value of those Bitcoin had risen to more than \$1 million. *Id.* The trustee argued that Bitcoin should be treated as a commodity that "fluctuates in price based upon market conditions," citing publications by the Commodity Future Trading Commission and the IRS. *Id.* at 1930. Thus, under this argument the trustee could choose to recover the Bitcoin's value at the time of filing or \$1 million. *Id.* The defendant, on the other hand, argued that Bitcoin serve as a form of currency, citing guidance from the Treasury Department's Financial Crimes Enforcement Network (FinCEN) from early 2013 and the Consumer Financial Protection Bureau's description of Bitcoin as currency-like. *Id.* Thus, the amount the trustee could avoid would have been much lower according to the Bankruptcy Code.

108. 7 U.S.C. §§ 2(a), 1a(9).

involving . . . contracts of sale of a commodity for future delivery.”<sup>109</sup> The term “futures trading” refers to a unique type of transaction that is especially critical to the agricultural industry.<sup>110</sup> They involve “futures contracts,” which are obligations to purchase or sell a certain quantity of an underlying asset at a set price at a specific time in the future.<sup>111</sup> When the time comes, the parties of a futures contract are bound to sell or buy the underlying asset according to the terms.<sup>112</sup> In a sense, the underlying asset eventually changes hands in the future according to a price set in the past. The markets for trading futures contracts “have grown to include those for energy and metal commodities[,] such as . . . gasoline . . . and silver,” and financial products, such as interest rates and foreign currency.<sup>113</sup> Those futures contracts are also known as derivatives contracts, because they derive value from the price of another asset: the underlying commodity.<sup>114</sup>

The CFTC’s mission is “to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation”<sup>115</sup> by “[p]roviding transparency to market participants about our rules and processes”<sup>116</sup> and fostering “open, competitive, and financially sound[] futures, options, and swaps markets.”<sup>117</sup> In simple terms, the CFTC “oversees the activities of firms and individuals who act as intermediaries between customers and markets.”<sup>118</sup> The CFTC has recently allowed specialized exchanges to conduct “futures relating to digital assets,” such as Bitcoin.<sup>119</sup>

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109. *Id.* § 2(a); *see also* Lucking & Aravind, *supra* note 68, at 3 (analyzing the advent of CFTC regulation of cryptocurrencies).

110. *See, e.g.,* B. Wade Brorsen & N’Zue F. Fofana, *Success and Failure of Agricultural Futures Contracts*, 19 J. AGRIBUSINESS 129, 129–31 (2001) (researching the effect of future trading in the agriculture industry).

111. ALAN N. RECHTSCHAFFEN, *CAPITAL MARKETS, DERIVATIVES, AND THE LAW: POSITIVITY AND PREPARATION* 376 (3d ed. 2019).

112. *See Basics of Futures Trading*, COMMODITY FUTURES TRADING COMM’N, <https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/FuturesMarketBasics/index.htm> [<https://perma.cc/K2PX-6XX2>].

113. COMMODITY FUTURES TRADING COMM’N, 2022 – 2026 STRATEGIC PLAN 3.

114. *See* Brian Misamore, *Understanding Financial Derivatives: Forwards, Futures, and Options*, HARV. BUS. SCH. ONLINE (Nov. 9, 2017), <https://online.hbs.edu/blog/post/understanding-financial-derivatives-forwards-futures-options> [<https://perma.cc/8VQP-Q56X>].

115. *About the CFTC: The Commission*, COMMODITY FUTURES TRADING COMM’N, <https://www.cftc.gov/About/AboutTheCommission> [<https://perma.cc/7JYQ-YEGE>].

116. *Id.*

117. COMMODITY FUTURES TRADING COMM’N, *supra* note 113, at 3.

118. RECHTSCHAFFEN, *supra* note 111, at 369.

119. COMMODITY FUTURES TRADING COMM’N, *supra* note 113, at 3.



## 2. *Classifying Cryptocurrency as a Commodity*

The CFTC became aware of the classification issue of cryptocurrency during cryptocurrency's early growth.<sup>120</sup> The CFTC first brought up the issue in an enforcement action in 2015 against Coinflip.<sup>121</sup> It found that Coinflip violated the Commodity Exchange Act<sup>122</sup> by creating an online platform and offering to connect buyers and sellers of Bitcoin options contracts without registering with the CFTC.<sup>123</sup> "The definition of a 'commodity' is broad,"<sup>124</sup> stated the CFTC: "Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities."<sup>125</sup> The Commodity Exchange Act defines the term "commodity" with a long list of products, including traditional agricultural products such as eggs, butter, wool, concentrated orange juice, and "all other goods and articles."<sup>126</sup> Furthermore, the term describes "all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in."<sup>127</sup>

In an action against crypto exchange Bitfinex in 2016, the CFTC again took the position that it has jurisdiction to regulate cryptocurrency transactions.<sup>128</sup> Specifically, the CFTC explained that the contractual relationship between Bitcoin purchasers and Bitfinex involved future delivery.<sup>129</sup> When a customer purchased a Bitcoin, the Bitcoin was held for the benefit of the buyer in Bitfinex's "omnibus settlement wallet."<sup>130</sup> The customer's interests in the wallet were accounted for in Bitfinex's database, but the wallet itself was owned and controlled by Bitfinex. Customers could not access their wallets or use the Bitcoin they purchased until the company released a "private key" to them.<sup>131</sup> The Commission found that the company had possession and control over the Bitcoin purchased by customers, and the company's book entries indicated that customers' interests in those Bitcoin were insufficient to constitute "actual

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120. See Isaac et al., *supra* note 42.

121. *In re Coinflip, Inc.*, CFTC No. 15-29, 2015 WL 5535736, at \*2 (Sept. 17, 2015); see also Lucking & Aravind, *supra* note 68, at 3 (summarizing the settlement order).

122. 7 U.S.C. §§ 1-27(f).

123. *In re Coinflip*, 2015 WL 5535736, at \*3.

124. *Id.*

125. *Id.*

126. 7 U.S.C. § 1a(9). "[A]ll other goods and articles" interestingly does not include onions or motion picture box office receipts. *Id.*

127. *Id.*

128. *In re BFXNA Inc.*, CFTC No. 16-19, 2016 WL 3137612, at \*4-6 (June 2, 2016).

129. *Id.*

130. *Id.* at \*3.

131. *Id.*

delivery.”<sup>132</sup> Bitfinex’s Bitcoin transactions did not result in “actual delivery” to the traders on Bitfinex’s platform.<sup>133</sup>

The CFTC argued that it should regulate Bitcoin and other digital tokens because the tokens remained under the possession and control of the company after a customer’s purchases; thus, the transactions involved future delivery.<sup>134</sup> In a 2022 article, the Chamber of Digital Commerce argued that Bitcoin should be treated as a commodity because “[it] and other cryptocurrencies behave like commodities.”<sup>135</sup> In its reasoning, the Chamber pointed out that each Bitcoin is identical and interchangeable, and Bitcoin’s market behavior is driven by supply and demand.<sup>136</sup> Bitcoin has been colloquially referred to as “digital gold” and gold is commonly considered a commodity.<sup>137</sup> Nevertheless, there is no “clear-cut definition” as to whether something is a commodity.<sup>138</sup> Cryptocurrency’s categorization here is mainly based on a broad reading of the statutory definition of “commodity” without examining any specific characteristics.

### 3. *Existing Case Law*

In past cases, federal courts have classified cryptocurrency as a commodity, concluding that the Commodity Exchange Act does not define “commodity” by “type, grade, quality, brand, producer, manufacturer, or form.”<sup>139</sup> In *CFTC v. My Big Coin Pay, Inc.*,<sup>140</sup> the defendant company operated a virtual currency scheme and fraudulently

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132. *Id.* at \*6 (citing Retail Commodity Transactions Under Commodity Exchange Act, 78 Fed. Reg. 52426, 52428 (Aug. 23, 2013)).

133. *Id.*

134. *Id.* at \*5–6.

135. *Why Is Bitcoin a Commodity?*, CHAMBER OF DIGIT. COM. (Nov. 8, 2022), <https://digitalchamber.org/bitcoin-commodity/> [<https://perma.cc/L42Z-EDTT>].

136. *Id.*

137. *Id.*

138. *Id.* The Chamber also pointed out that “securities are commodities but not all commodities are securities.” *Id.*

139. *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492, 497 (D. Mass. 2018); *see also* *CFTC v. Reynolds*, No. 1:19-cv-05631, 2021 WL 796683, at \*5 (S.D.N.Y. Mar. 2, 2021) (“Virtual currencies such as Bitcoin are encompassed in the definition of ‘commodity’ under Section 1a(9) of the Act.” (citation omitted)); *CFTC v. Laino Grp. Ltd.*, No. 4:20-cv-03317, 2021 WL 4059385, at \*6 (S.D. Tex. June 30, 2021) (concluding that Bitcoin is a commodity (citing *Reynolds*, 2021 WL 796683, at \*5)); *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 228 (E.D.N.Y. 2018) (“Virtual currencies can be regulated by CFTC as a commodity. Virtual currencies are ‘goods’ exchanged in a market for a uniform quality and value.” (quoting Mitchell Prentis, Note, *Digital Metal: Regulating Bitcoin as a Commodity*, 66 CASE W. RES. L. REV. 609, 626 (2015))).

140. 334 F. Supp. 3d 492 (D. Mass. 2018).

offered sale of a token called “My Big Coin.”<sup>141</sup> The defendants claimed that the coin was “backed by gold” and could be used “anywhere Mastercard was accepted.”<sup>142</sup> The purchasers of My Big Coin could view their accounts online but could not trade the coin or withdraw funds.<sup>143</sup> The CFTC brought suit, alleging violation of the CEA.<sup>144</sup> The defendants contended that My Big Coin cannot be a commodity under the CEA; but the court rejected their arguments, reasoning that Congress intended to provide an “expansive” definition of commodity to ensure the CEA’s comprehensive protection on the markets.<sup>145</sup> Characterizing My Big Coin as a commodity ensured effective enforcement of the CEA and the CFTC’s regulatory scheme.<sup>146</sup>

In *United States v. Reed*,<sup>147</sup> the government argued that the defendant was required to register his company, BitMEX, with the CFTC.<sup>148</sup> BitMEX operated as an online platform that facilitated the trading of futures contracts and other derivative products tied to Bitcoin’s value.<sup>149</sup> Reed argued he did not have notice that Bitcoin was a commodity, but the court found that the CEA’s broad definition of commodities gave Reed “ample notice.”<sup>150</sup>

[U]nder the plain language of the CEA, cryptocurrencies fall within the definition of commodities. This plain language is buttressed by a core characteristic that cryptocurrencies share with other commodities whose derivatives are regulated by the CFTC – namely, that they are “exchanged in a market for a uniform quality and value.”<sup>151</sup>

The court in *Reed* also opined on the classification debate of Bitcoin. The defendant argued that cryptocurrencies are sometimes categorized as “investment contracts,” which fall under the jurisdiction of the Securities and Exchange Commission (SEC).<sup>152</sup> However, “the fact that cryptocurrencies may be regulated under additional statutes . . . does not

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141. *Id.* at 494.

142. *Id.*

143. *Id.*

144. *Id.* at 494–95.

145. *Id.* at 497.

146. *Id.*

147. No. 20-cr-500, 2022 WL 597180 (S.D.N.Y. Feb. 28, 2022).

148. *Id.* at \*1.

149. *Id.* at \*2.

150. *Id.* at \*3.

151. *Id.* at \*4 (citation omitted) (quoting *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 228 (E.D.N.Y. 2018)).

152. *Id.* at \*4; *see supra* section II.B.

mean that a cryptocurrency is not a ‘commodity’ within the meaning of the CEA,” and “several agencies may have concurrent regulatory authority in the cryptocurrency space.”<sup>153</sup>

An earlier case, *CFTC v. McDonnell*,<sup>154</sup> elaborated on the idea that defining cryptocurrencies as commodities does not preclude other characterizations.<sup>155</sup> The court first looked to the CEA, which regulates “all other goods and articles” involving futures trading.<sup>156</sup> Based on this language and the common understanding of “goods,” the court concluded that digital currencies could be characterized as commodities.<sup>157</sup> However, the court also held that “[t]he jurisdictional authority of CFTC to regulate virtual currencies as commodities does not preclude other agencies from exercising their regulatory power when virtual currencies function differently than derivative commodities.”<sup>158</sup>

The federal courts so far have supported the characterization of cryptocurrencies as commodities and recognized the authorities of the CFTC on the matter. However, the courts have also acknowledged that the CFTC might share authority with other state and federal administrative agencies in the crypto space—at least until Congress provides further clarifications.

## B. *The SEC’s Authorities to Regulate Cryptocurrency as a Security*

### 1. *The Securities and Exchange Commission*

If cryptocurrency is considered a security, its regulation would fall under the jurisdiction of the SEC. The SEC was created in 1934 as one of President Roosevelt’s New Deal initiatives.<sup>159</sup> The agency is aimed at reviving the economy and preventing future market catastrophes.<sup>160</sup> The stock market crash in 1929 destroyed public confidence and caused bank closures, job loss, and bankruptcies.<sup>161</sup> Congress made significant legislative efforts in the next decade to propose regulations on the

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153. *Id.* at \*4 (citation omitted).

154. 287 F. Supp. 3d 213 (E.D.N.Y. 2018).

155. *Id.* at 228.

156. *Id.* (citing Prentis, *supra* note 139, at 626); 7 U.S.C. § 1a(9).

157. *McDonnell*, 287 F. Supp. 3d at 228.

158. *Id.*

159. SEC: *Securities and Exchange Commission*, HISTORY (Dec. 6, 2019), <https://www.history.com/topics/us-government/securities-and-exchange-commission> [<https://perma.cc/X6YM-9WAQ>].

160. *Id.*

161. *Id.*

securities industry, including the Securities Act of 1933 (1933 Act)<sup>162</sup> and the Securities Exchange Act of 1934 (1934 Act).<sup>163</sup> The aim of the 1933 Act was to provide “full and fair disclosure of the character of securities sold” and to prevent fraudulent securities sales.<sup>164</sup> It requires the registration of securities to allow investors to make informed decisions.<sup>165</sup> The 1934 Act established the SEC and empowered it with broad authority to enforce federal securities laws.<sup>166</sup> The 1934 Act regulates “securities exchanges and of over-the-counter markets” and prevents “inequitable and unfair practices on such exchanges and markets.”<sup>167</sup>

The registration requirement as set forth in the 1933 Act is key to securities regulations. All offers and sales of securities, including those involving a digital asset, must either be properly registered with the SEC or qualify for an exemption.<sup>168</sup> The registration requires disclosure of information necessary to enable prospective purchasers to make an informed investment decision, such as the issuer’s financial condition, the identity and background of management, and the amount of securities to

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162. Securities Act of 1933, 15 U.S.C. §§ 77a–77mm; *see also* James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30–35 (1959) (discussing the introduction of the bill that became the Securities Act of 1933 and Congress’s concern over securities trading in the market).

163. 15 U.S.C. §§ 78a–78rr; *see also* John Hanna, *The Securities Exchange Act of 1934*, 23 CALIF. L. REV. 1, 1–5 (1934) (discussing key components and functions of the Securities Exchange Act of 1934).

164. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (“AN ACT To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes.”).

165. *The Law That Governs the Securities Industry*, U.S. SEC. & EXCH. COMM’N, <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry> [<https://perma.cc/5PJX-QQBV>] (briefly describing the purpose and actions of the Act, including the “require[ment] that investors receive financial and other significant information concerning securities being offered for public sale”); *see, e.g.*, 15 U.S.C. § 77f (providing that “[a]ny security may be registered with the Commission” and “[t]he information contained in or filed with the registration shall be made available to the public” (emphasis added)); *see also* Landis, *supra* note 162, at 30–35 (discussing publicity and information, changes in the registration requirements and reciting the legislative history).

166. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934); *see also* *The Law That Governs the Securities Industry*, U.S. SEC. & EXCH. COMM’N: INVESTOR.GOV, <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry> [<https://perma.cc/5PJX-QQBV>] (providing a brief description of the 1934 Act).

167. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (“AN ACT To provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.”).

168. *Framework for “Investment Contract,” supra* note 104.

be offered.<sup>169</sup> The SEC emphasizes the importance of reducing “information asymmetries” between “promoters of the enterprise on the one hand, and investors and prospective investors on the other hand.”<sup>170</sup> Much like the CFTC,<sup>171</sup> the SEC helps maintain the confidence of market participants. However, the SEC occupies a specific market sector and has different regulatory powers. Such distinctions are at the center of the crypto classification debate as they are relevant to the scope and reach of the two agencies’ regulatory powers.

## 2. *Classifying Cryptocurrency as a Security*

The SEC has regulatory authority over “securities,” which generally describes financial investment avenues like stocks, bonds, and investment contracts.<sup>172</sup> The last category—investment contracts—is where crypto potentially belongs.<sup>173</sup> In 2017, SEC Chairman Jay Clayton issued a statement on “initial coin offerings” and concluded that certain token transactions can be considered investment contracts<sup>174</sup> based on the holding from a landmark Supreme Court case on U.S. federal securities laws: *SEC v. W.J. Howey Co.*<sup>175</sup> The case provided a framework—the *Howey* test—for analyzing whether a transaction is an investment contract within the meaning of the 1933 Act.<sup>176</sup> *Howey* defines an investment contract in three parts: (1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits derived solely from the efforts of others.<sup>177</sup>

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169. See *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 360 (S.D.N.Y. 1998), *aff’d*, 155 F.3d 129 (2d Cir. 1998); Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (DAO, Exchange Act Release No. 81207), 117 SEC Docket 745, 2017 WL 7184670, at \*10 (July 25, 2017).

170. *Framework for “Investment Contract” Analysis of Digital Assets*, *supra* note 104.

171. See *supra* section II.A.

172. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10).

173. *Framework for “Investment Contract” Analysis of Digital Assets*, *supra* note 104.

174. Press Release, Jay Clayton, Chairman, U.S. Sec. & Exch. Comm’n, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11> [<https://perma.cc/D24A-EHJP>].

175. 328 U.S. 293 (1946).

176. *Id.* at 298–99.

177. *Id.*; see also *Consolo v. Hornblower & Weeks-Hemphill, Noyes, Inc.*, 436 F. Supp. 447, 450–51 (N.D. Ohio 1976) (noting that cash deposits into a trading account clearly constitute an investment of money); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478 (5th Cir. 1974) (noting that “purchasers of supervisorships and distributorships made an investment of money”); *Stowell v. Ted S. Finkel Inv. Servs., Inc.*, 489 F. Supp. 1209, 1220 (S.D. Fla. 1980) (noting that contributing capital to a limited partnership venture is “clearly an investment of money”); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852–53 (1975) (“The touchstone is the presence of an investment in a common

To be “an investment of money,” the investment made does not have to be cash but may be goods, services, or some change of value.<sup>178</sup> “Profits” include period payments like dividends or an increase in the value of the investment.<sup>179</sup> The “efforts of others” should be “undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”<sup>180</sup> The three elements must be examined in light of the transaction’s substance instead of its form.<sup>181</sup> The principle behind this definition is flexible rather than static and “is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”<sup>182</sup>

The SEC has applied the *Howey* test to cryptocurrency transactions. In a report issued by the SEC in 2017, the agency stressed that federal securities laws may apply to “distributed ledger technology” regardless of “the form of the organization or technology used to effectuate a particular offer or sale.”<sup>183</sup> The report originated from the SEC’s investigation of whether an unincorporated entity, the DAO, had violated federal securities laws.<sup>184</sup> The DAO existed only virtually and sold DAO Tokens—a cryptocurrency created by the entity itself—to investors in exchange for assets.<sup>185</sup> The DAO then used the pooled assets to fund profitable projects and earn returns both for the entity and for the token purchasers.<sup>186</sup> The SEC questioned whether securities laws should be applied to the offers and sales of DAO Tokens and gave a fact-specific “yes”: the DAO Token transactions satisfied the three elements of an investment contract.<sup>187</sup> The purchase of DAO Tokens was an investment

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venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.”).

178. *Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991) (citation omitted).

179. *SEC v. Edwards*, 540 U.S. 389, 394 (2004); *SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 179 (S.D.N.Y. 2020).

180. *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973); *see also Koscot Interplanetary*, 497 F.2d at 483 (adopting *Glenn*’s interpretation of *Howey*); *Baurer v. Plan. Grp., Inc.*, 669 F.2d 770, 779 (D.C. Cir. 1981) (applying the *Glenn* test).

181. *See Consolo*, 436 F. Supp. at 450 (citation omitted); *Stowell*, 489 F. Supp. at 1219 (first citing *United Hous. Found.*, 421 U.S. at 851–52; and then citing *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)).

182. *Howey*, 328 U.S. at 299.

183. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207, 117 SEC Docket 745, 2017 WL 7184670, at \*7 (July 25, 2017).

184. The acronym “DAO” stands for “Decentralized Autonomous Organization.” *Id.* at \*1.

185. *Id.*

186. *Id.*

187. *Id.* at \*7–12.

of value.<sup>188</sup> The DAO's funders even compared the rewards it offered to the investors as getting "dividends,"<sup>189</sup> and the investors' money was pooled together to generate returns based on managerial efforts.<sup>190</sup> The SEC has advised those who use an entity like The DAO or other "blockchain-enabled means for capital raising"<sup>191</sup> to comply with the federal securities laws, especially if they are considering an Initial Coin Offering (ICO).<sup>192</sup>

### 3. *Existing Case Law*

The federal courts have generally followed the *Howey* test when determining if a cryptocurrency transaction is an investment contract and should be governed by securities laws. In *SEC v. Shavers*,<sup>193</sup> the defendant was involved in the business of "selling Bitcoin to a group of local people" and offered investors up to 1% interest daily.<sup>194</sup> The court considered whether the case involved an investment of contract subject to securities regulations and concluded that it did.<sup>195</sup> Investment of Bitcoin was an investment of money as Bitcoin remained exchangeable for conventional currencies; there was a common enterprise as the investors collectively relied on the defendant's expertise; and the investors anticipated a return from the efforts of the defendant.<sup>196</sup> The three elements of the *Howey* test were all satisfied.

In *SEC v. Kik Interactive Inc.*,<sup>197</sup> a district court held that the defendant organization offered and sold securities without first registering with the SEC.<sup>198</sup> Kik created and sold digital currency called "Kin" for "buying

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188. *Id.* at \*8.

189. *Id.* at \*2, \*9; *see also* *SEC v. Int'l Loan Network, Inc.*, 968 F.2d 1304, 1308 (D.C. Cir. 1992) ("As for the common enterprise element, the fortunes of investors are clearly linked to each other and to the success of ILN as an enterprise.").

190. DAO, Exchange Act Release No. 81207, 2017 WL 7184670, at \*12–15.

191. *Id.* at \*2.

192. *See id.* at \*10. An ICO is a novel way for entrepreneurial ventures to finance: a venture offers a set number of crypto tokens for sale "with the promise that those tokens will operate as the only medium of exchange when accessing the venture's future products," promising the growth in value of those tokens and their utilities in the future, after the initial sales generate capital to fund the venture's development. Christian Catalini & Joshua S. Gans, *Initial Coin Offerings and the Value of Crypto Tokens 2* (Univ. of Toronto, Rotman Sch. Mgmt., Working Paper No. 3137213, 2019).

193. 2014 WL 12622292 (E.D. Tex. Aug. 26, 2014).

194. *Id.* at \*2.

195. *Id.* at \*6.

196. *Id.* at \*5–6.

197. 492 F. Supp. 3d 169 (S.D.N.Y. 2020).

198. *Id.* at 173.



and selling digital products . . . across different applications.”<sup>199</sup> They planned a “[r]oadshow” to promote Kin, highlighted Kin’s fixed supply, and conducted both a private offering and a public offering.<sup>200</sup> The agreement entered into by the purchasers and Kik stated that “the Right created by this instrument is a security and that the offers and sales of this Right have not been registered under any country’s securities laws and, therefore, cannot be resold.”<sup>201</sup> Kik had received payments by purchasers through the sales and controlled “90% of all issued and outstanding tokens.”<sup>202</sup>

The *Kik* court followed a flexible definition of investment contract and focused on analyzing the last two elements in the *Howey* test. A common enterprise can be established by a showing of “horizontal commonality”: where “the tying of each individual investor’s fortunes to the fortunes of the other investors by the pooling of assets” and when “the fortunes of each investor depend upon the profitability of the enterprise as a whole.”<sup>203</sup> The court concluded that Kik established a common enterprise as they deposited funds into a single bank account, used the funds in its operations, and created a digital ecosystem where investors’ profits depended on the increased value of its tokens.<sup>204</sup> The court then concluded that there was a reasonable expectation of profits on the efforts of others based on how Kik marketed the scheme.<sup>205</sup> Kik emphasized Kin’s “profit-making potential,” and the value of Kin would not grow without relying heavily on the entity’s “entrepreneurial and managerial efforts.”<sup>206</sup> Kik strived to create an ecosystem rooted in Kin by creating new products and services, so that “without the promised digital ecosystem, Kin would be worthless.”<sup>207</sup> Because Kik had to be the primary driver of the Kin ecosystem, the court found that the third element of the *Howey* test was met.<sup>208</sup>

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199. *Id.* at 174.

200. *Id.*

201. *Id.*

202. *Id.* at 175.

203. *Id.* at 178 (quoting *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994)).

204. *Id.*

205. *Id.* at 179.

206. *Id.* at 180.

207. *Id.* at 180.

208. *Id.* at 180.

### C. *The Digital Commodities Consumer Protection Act*

When Congress introduced the Digital Commodities Consumer Protection Act in 2022, aiming to provide clarity on the classification of crypto, the debate over cryptocurrency's definition took a turn. The bill intends to amend the Commodity Exchange Act (CEA) and expand the Commodity Futures Trading Commission's jurisdiction.<sup>209</sup> Noticeably, the bill defines a new term "digital commodity," which means a "fungible digital form of personal property that can be possessed and transferred person-to-person without necessary reliance on an intermediary" and explicitly includes cryptocurrencies such as Bitcoin.<sup>210</sup> Interestingly, the bill seems to make an effort not to interfere with the blockchain technology behind cryptocurrencies, as it specifies multiple times that the term "digital commodity broker" does not include a person "solely because that person validates digital commodity transactions."<sup>211</sup>

This bill aims to grant general authority to the CFTC to regulate "digital commodity" market transactions. If the bill is passed, many crypto exchanges would be treated as digital commodity trading facilities and their transactions would require CFTC approval.<sup>212</sup> On its face, the bill seems to situate cryptocurrencies generally as a commodity. In a press release, Congressman Michael Conaway expressed hope that the bill would close the hole in regulation between the CFTC and the SEC by simplifying and clarifying cryptocurrency's legal status while serving the interests of both companies and consumers.<sup>213</sup> However, the language of the bill does not truly resolve the characterization issue of cryptocurrencies, as the definition of "digital commodity" explicitly

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209. Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022) ("To amend the Commodity Exchange Act to provide the Commodity Futures Trading Commission jurisdiction to oversee the spot digital commodity market, and for other purposes.").

210. *Id.* § 2(a)(7).

211. *Id.*

212. Daniel N. Budofsky, Megan L. Jones & Max A. Winograd, *Digital Commodities Consumer Protection Act Seeks to Provide Oversight of Digital Assets*, PILLSBURY (Aug. 16, 2022), <https://www.pillsburylaw.com/en/news-and-insights/digital-commodities-consumer-protection-act-digital-assets.html> [<https://perma.cc/JG68-PVPH>].

213. Press Release, U.S. House Comm. on Agric., Conaway Introduces Digital Commodity Regulatory Framework (Sept. 24, 2020), <https://agriculture.house.gov/news/documentsingle.aspx?DocumentID=6773> [<https://perma.cc/8EAX-ZXC7>]; Becky Powell, *Regulating the Unregulatable: The Digital Commodity Exchange Act's Use-Based Approach to Cryptocurrency Regulation*, 2021 B.C. INTELL. PROP. & TECH. F. 1, 9 (2021).

excludes “a security.”<sup>214</sup> The bill does mention circumstances where digital assets constitute securities, seemingly leaving it to the discretion of the SEC.<sup>215</sup> In a way, the bill gives CFTC jurisdiction only over “digital commodities” while sidestepping the harder question of what qualifies as a digital commodity.<sup>216</sup> The CFTC has broadly announced that cryptocurrencies are commodities, yet speculations and uncertainties continue as to the classification of cryptocurrencies.<sup>217</sup>

### III. THE BANKRUPTCY SYSTEM

While the classification of cryptocurrency has been debated for regulatory purposes, the downturn of the crypto market in 2022 made the debate relevant to the bankruptcy courts. In order to understand how cryptocurrency’s classification affects bankruptcy proceedings, the following sections provide an introduction to the bankruptcy system, its functions, and its procedures.

#### A. *Key Concepts in Bankruptcy*

Bankruptcy signals that the filer is in dire financial trouble and is in need of guidance.<sup>218</sup> At its core, bankruptcy is about examining competing creditor claims when there might not be enough money to pay everyone who is owed.<sup>219</sup> The bankruptcy system was created by Congress through a series of enactments and amendments,<sup>220</sup> now compiled as the United States Bankruptcy Code under Title 11 of the United States Code.<sup>221</sup> The Code contains rules for different types of bankruptcy proceedings as

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214. Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. § 2(a)(7) (2022).

215. Budofsky et al., *supra* note 212.

216. See Jack Solowey, *The Hard Thing About Crypto Purgatory*, CATO INST. (Sept. 12, 2022), <https://www.cato.org/blog/hard-thing-about-crypto-purgatory> [<https://perma.cc/CW5V-49BN>].

217. Erin Camp & Art Cavazos, *Cryptocurrency: A Commodity, a Security, or a Scam?*, JACKSON WALKER (Dec. 14, 2022), <https://www.jw.com/news/frb-cryptocurrency/> [<https://perma.cc/6WAE-35VZ>]; William A. Powers, *Is Crypto a Security or Commodity? Look to Congress’ Ethics Rules*, BLOOMBERG L. (July 14, 2022) <https://news.bloombergtax.com/crypto/is-crypto-a-security-or-commodity-look-to-congress-ethics-rules> [<https://perma.cc/9QWW-9EQM>].

218. See ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, KATHERINE PORTER & JOHN A. E. POTTOW, *THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS* 3 (8th ed. 2021).

219. *Id.*

220. For a brief overview of the history of bankruptcy laws, see Robert Jacobvitz, *A Relatively Short History of the Bankruptcy Laws in the United States*, NCBJ 93RD ANN. CONF. BLOG (Feb. 27, 2019) <https://ncbjmeeting.org/2019blog/2019/02/27/a-relatively-short-history-of-the-bankruptcy-laws-in-the-united-states/> [<https://perma.cc/L8DJ-DW53>]; WARREN ET AL., *supra* note 218, at 9–12 (providing a brief history of U.S. bankruptcy law).

221. 11 U.S.C. §§ 101–1532.

distinguished by its chapters, including Chapter 7, Chapter 13, and Chapter 11 bankruptcies.<sup>222</sup> When the crypto companies filed for bankruptcy, most of them filed for Chapter 11 bankruptcy,<sup>223</sup> which has a primary goal of formulating “a comprehensive reorganization plan.”<sup>224</sup> It usually involves a corporate entity with complex financial needs that is hoping to continue doing business and pay creditors over time.<sup>225</sup>

A “creditor” under the Code is an entity that has a claim against the debtor, and such a claim arose before the debtor commenced bankruptcy.<sup>226</sup> The term “claim,” then, refers to a “right to payment” or a “right to an equitable remedy for breach of performance.”<sup>227</sup> It would be a mistake, however, to conclude that every creditor is treated equally.<sup>228</sup> A central component of bankruptcy—paying creditors—revolves around the key concept of “priority,” which refers to the order according to which the creditors will receive any distributions from the bankruptcy estate.<sup>229</sup> Secured creditors, or those who hold a lien on any property now gathered in the bankruptcy estate, are first in line to be paid out of their collateral.<sup>230</sup> Only after the secured creditors do the unsecured creditors receive any distribution, or creditors who cannot cash any collateral in repayment of debt.<sup>231</sup> Among the unsecured creditors, there are further priority divisions.<sup>232</sup> The Bankruptcy Code lists the order of priority for the unsecured creditors under Section 507.<sup>233</sup> As for the creditors who are not listed in Section 507, they are considered general unsecured creditors and

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222. *Id.* §§ 701–784, 1101–1195, 1301–1330.

223. See Clay Roberts, *The Crypto Bankruptcy Wave*, AM. BAR ASS’N (Feb. 21, 2023), [https://www.americanbar.org/groups/business\\_law/resources/business-law-today/2023-march/the-crypto-bankruptcy-wave/](https://www.americanbar.org/groups/business_law/resources/business-law-today/2023-march/the-crypto-bankruptcy-wave/) [https://perma.cc/5MBH-WNHC].

224. *Tamir v. United States Tr.*, 566 B.R. 278, 283 (D. Me. 2016); see also *In re FBI Distrib. Corp.*, 330 F.3d 36, 41 (1st Cir. 2003) (emphasizing that “[t]he paramount objective of a Chapter 11 reorganization is to rehabilitate and preserve the value of the financially distressed business” through the confirmation of a debtor-proposed plan).

225. See WARREN ET AL., *supra* note 218, at 341–43.

226. 11 U.S.C. § 101(10).

227. *Id.* § 101(5).

228. Richard M. Hynes & Steven D. Walt, *Inequality and Equity in Bankruptcy Reorganization*, 66 KAN. L. REV. 875, 875 (2018) (“The maxim that in bankruptcy ‘equity is equality’ routinely is invoked by courts and commentators. The goal of bankruptcy law, it is often said, is to treat creditors equally. In fact, the maxim is not reflected in the Bankruptcy Code.”).

229. See generally *id.* at 877.

230. See 11 U.S.C. § 506(a)(1). Secured creditors are still subject to the bankruptcy process because the bankruptcy court still needs to release the property from the bankruptcy estate. See *id.*; *id.* § 541(a) (stating that debtor’s properties are gathered into a bankruptcy estate).

231. See *In re Dinh*, 80 B.R. 819, 822 (Bankr. S.D. Miss. 1987).

232. 11 U.S.C. § 507.

233. *Id.*

receive asset distribution after the creditors listed in Section 507.<sup>234</sup> If their claims are timely filed with the court, they are likely next in line.<sup>235</sup>

Debtors hope to get a discharge at the end of a bankruptcy proceeding. A discharge operates as an injunction against any creditor action to collect, recover, or offset their debt as a personal liability of the debtor.<sup>236</sup> In other words, a discharge eliminates a debt as a personal liability—if unsecured creditors did not recover the full amount of their claims, the amount they can receive or agreed to receive during the bankruptcy process is all they can recover.<sup>237</sup> Discharge is the principal advantage bankruptcy offers to debtors and operates to release them from past obligations, “granting the debtor a financial ‘fresh start.’”<sup>238</sup> In a Chapter 11 bankruptcy, where the debtor may propose a plan to repay creditors,<sup>239</sup> the Bankruptcy Code provides that the confirmation of such a plan serves the function of a discharge.<sup>240</sup> After confirmation of a plan, the properties involved in the plan are “free and clear of all claims and interests of creditors.”<sup>241</sup>

Creditors are not without protections, however. Discharge is a privilege, not a right, and has exceptions.<sup>242</sup> A trustee or creditor can object to the debtor’s discharge of a particular debt if it is of the kind that Congress has deemed should survive bankruptcy.<sup>243</sup> Because the debtor ultimately benefits from their debts being discharged at the end of a bankruptcy, Congress is concerned about potential abuse of the bankruptcy system, where debtors see an out and become careless with their actions.<sup>244</sup> Congress thus set out exceptions to discharge as a matter

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234. Alexandra Dugan & Erin Malone-Smolla, *Bankruptcy Basics: Secured vs. Unsecured Claims*, NAT’L L. REV. (Apr. 29, 2021), <https://www.natlawreview.com/article/bankruptcy-basics-secured-vs-unsecured-claims> [https://perma.cc/6WP6-D7YV]; see 11 U.S.C. § 507.

235. Hynes & Walt, *supra* note 228, at 877 (explaining that whatever proceeds remain will go first to unsecured creditors whose “claims . . . were timely filed,” and then to “unsecured claims that were filed late”).

236. 11 U.S.C. § 524(a).

237. See *In re Henry*, 266 B.R. 457, 474 (Bankr. C.D. Cal. 2001).

238. Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1393 (1985).

239. 11 U.S.C. § 1121.

240. *Id.* § 1141.

241. *Id.* § 1141(c).

242. WARREN ET AL., *supra* note 218, at 148.

243. See generally 11 U.S.C. §§ 523, 727.

244. See Judith Benderson, *Introduction: A History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, U.S. ATT’YS’ BULL. (U.S. Dep’t of Just.), July 2006, at 1 (“The controversy within the bankruptcy community was, and continues to be, whether or not it is too easy for individual debtors to ‘abuse’ the bankruptcy system.

of public policy, aiming to retain some consequences resulting from the debtor's past actions.<sup>245</sup> Section 523(a)(19) of the Bankruptcy Code provides a list of items that are not dischargeable if certain conditions are met.<sup>246</sup> If a creditor's claim qualifies for an exception, the debtor remains responsible to such creditor's claim according to its terms even after the bankruptcy. The creditor then can use other legal measures to recover.<sup>247</sup>

Notably, the Code specifically creates a discharge exception for debts in violation of any federal or state securities laws under Section 523(a)(19)(A)(i).<sup>248</sup> The Code provides a two-part test to qualify for this exception. First, the debt must be for the violation of federal securities laws, including the Securities Exchange Act, or for common law fraud, deceit, or manipulation in connection with the purchase or sale of any security.<sup>249</sup> Second, the debt must result "before, on, or after the date on which the petition was filed" from "any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding" or "any court or administrative order for any damages, fine, penalty, . . . or other payment owed by the debtor."<sup>250</sup>

The legislative history relating to Section 523(a)(19) emphasizes that the purpose of this section is to protect investors. By enacting this section of the Code, Congress intended to "amend the federal bankruptcy code to

Abuse is defined as discharging debts which debtors theoretically could afford, at least in part, to pay.").

245. It is notable that certain exceptions result from lobbying by various interest groups. *See, e.g.*, 11 U.S.C. § 523(a)(16) (condominium membership associations, cooperative corporations, and homeowners associations).

246. *Id.* § 523(a)(19); *In re Clements*, 570 B.R. 803, 808 (Bankr. W.D. Wis. 2017) ("If the state court judgment falls within the ambit of section 523(a)(19), the debt is nondischargeable.").

247. 11 U.S.C. § 523(a).

248. *Id.* § 523(a)(19)(A)(i) (denying discharge of debts for "the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under Federal or State securities laws").

249. *Id.* § 523(a)(19)(A).

250. *Id.* § 523(a)(19)(B). The Code provides that a debt is not discharged:

(19) that—(A) is for—(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and (B) results, before, on, or after the date on which the petition was filed, from—(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding; (ii) any settlement agreement entered into by the debtor; or (iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

*Id.* § 523(a)(19); *see also In re Clements*, 570 B.R. at 808 ("Essentially, a debtor cannot discharge his or her debt if two conditions are satisfied: first, the debt stems from a violation of securities laws or a fraud in connection with the purchase or sale of a security, and second, the debt is memorialized in a judicial or administrative order or settlement agreement.").

make judgments and settlements arising from state and federal securities law violations brought by state or federal regulators and private individuals non-dischargeable.”<sup>251</sup> Congress intended to close the “loophole” in the law where bankruptcy law permits wrongdoers to discharge their obligations from securities fraud and other securities violations and “help defrauded investors recoup their losses and to hold accountable those who incur debts by violating our securities laws.”<sup>252</sup> At least one bankruptcy court has considered the issue of whether individual investors may assert a federal securities law violation and concluded that a private plaintiff has at least the ability to plead the elements of Section (a)(19)(A)(ii) related to common law fraud in securities transactions.<sup>253</sup> The Bankruptcy Code provides a tool for investors—especially individual investors—to recover their interests when they are harmed from violations of federal securities laws.

### B. Chapter 11 Bankruptcy

Why did the cryptocurrency companies choose to file for Chapter 11 bankruptcy? Chapter 11 bankruptcy is an invitation to negotiate.<sup>254</sup> It aims to produce a visible plan to pay the creditors while keeping the company in operation—in other words, it stabilizes a company that is in financial crisis.<sup>255</sup> Moreover, a unique feature of Chapter 11 bankruptcy is that the debtor’s existing management can stay in control of the debtor company’s operations throughout the bankruptcy proceeding.<sup>256</sup> While Chapter 11 bankruptcy is available for individuals and corporate entities, this Comment focuses on its impact on corporate entities.

Functionally, in a Chapter 11 bankruptcy, the debtor entity’s operational and financial matters are subject to reconsideration.<sup>257</sup> Upon filing for Chapter 11 bankruptcy, the debtor is given an exclusive right by the Bankruptcy Code to propose a reorganization plan within a limited

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251. S. REP. NO. 107-146, at 12, 33 (2002); *see also In re Weilein*, 319 B.R. 175, 179 (Bankr. N.D. Iowa 2004) (“When there is no conflict between the language of the statute and the legislative history, and the court’s ‘plain language’ interpretation is not at odds with the statute’s obvious purpose, the statutory language itself must prevail.”).

252. S. REP. NO. 107-146, at 10 (2002).

253. *See In re Weilein*, 319 B.R. at 177–78.

254. WARREN ET AL., *supra* note 218, at 341.

255. *Id.*

256. *See* WARREN ET AL., *supra* note 218, at 341; 11 U.S.C. § 1107.

257. WARREN ET AL., *supra* note 218, at 581.

amount of time.<sup>258</sup> However, in order to confirm the plan, “a statutory majority of each class of creditors must vote in favor of the plan.”<sup>259</sup> The creditors are put into “classes” based on some common characteristic or plausible business reasons, so their decision should reflect the group’s interest.<sup>260</sup> Within each class, creditors who hold at least “two-thirds in amount and more than one-half in the number of the allowed claims” of their group must vote yes.<sup>261</sup> This voting requirement gives the debtors an incentive to negotiate with the creditors to arrive at an acceptable deal before presenting a plan.<sup>262</sup>

A reorganization plan technically does not meet the requirements for confirmation if any creditor class rejects the plan.<sup>263</sup> However, the Bankruptcy Code allows the debtor to override the stubborn objections of creditors to “confirm the plan notwithstanding the requirements.”<sup>264</sup> If the plan meets certain standards, the unhappy creditor class must swallow a bitter pill, enduring a bankruptcy “cramdown.”<sup>265</sup> Such a decision to confirm the plan without regard to a class objection is within the bankruptcy courts’ discretion, but they can only do so if the plan “does not discriminate unfairly, and is fair and equitable, with respect to each [impaired] class of claims” that has not accepted the plan.<sup>266</sup>

The phrase “discriminate unfairly” or what is “fair and equitable” are defined through case law. A plan does not “discriminate unfairly” if there is “a rational or legitimate basis for the discrimination and the discrimination must be necessary for the reorganization.”<sup>267</sup> The “fair and

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258. 11 U.S.C. § 1121(b) (“Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.”). The debtor can request an extension to the 120-day period. *Id.* § 1121(d)(1).

259. WARREN ET AL., *supra* note 218, at 581; 11 U.S.C. § 1126(c).

260. *See, e.g., In re Bernhard Steiner Pianos USA, Inc.*, 292 B.R. 109, 113–18 (Bankr. N.D. Tex. 2002) (classifying creditors based on whether their claims arose from consigned goods or they only have general unsecured claims).

261. 11 U.S.C. § 1126(c).

262. WARREN ET AL., *supra* note 218, at 581.

263. 11 U.S.C. § 1129(a)(7)–(8); *see also* WARREN ET AL., *supra* note 218, at 625 (discussing the plan confirmation process when there are creditor objections).

264. 11 U.S.C. § 1129(b)(1).

265. *See* WARREN ET AL., *supra* note 218, at 625 (“Cramdown is the available strategy to reorganize when despite the debtor’s best efforts at gerrymandering-cum-classification, the debtor faces a recalcitrant class that insists on voting no.”). The word “cramdown” is nowhere in the statute but is common jargon. *Id.*

266. 11 U.S.C. § 1129(b)(1).

267. *In re Crosscreek Apartments, Ltd.*, 213 B.R. 521, 537 (Bankr. E.D. Tenn. 1997); *see also In re Ambanc La Mesa Ltd. P’ship*, 115 F.3d 650, 656 (9th Cir. 1997) (“Discrimination between classes must satisfy four criteria to be considered fair under 11 U.S.C. § 1129(b): (1) the discrimination must be supported by a reasonable basis; (2) the debtor could not confirm or consummate the Plan without



equitable” requirement, on the other hand, traditionally implies an “absolute priority rule” for the unsecured creditors: if the debtor decides to cramdown their objection to the reorganization plan, no one behind the objecting unsecured creditors will receive anything before the unsecured creditors are paid in full.<sup>268</sup> This requirement begs the question: who is normally behind the unsecured creditors? The answer is equity holders, who are often the debtor themselves or their agents.<sup>269</sup> In a Chapter 11 case, it is likely that the executives of the entity which filed for bankruptcy are the equity holders—if they try to cramdown the plan while managing the entity during bankruptcy, all the stockholders lose their shares.<sup>270</sup> In essence, the Bankruptcy Code sets a limitation: the debtor’s proposed plans should not provide too good of a deal for the debtor’s owners.<sup>271</sup> The debtor’s behavior in seeking bargains for itself requires “a clear standard of fairness and judicial control.”<sup>272</sup>

#### IV. THE CLASSIFICATION OF CRYPTOCURRENCY IN BANKRUPTCY PROCEEDINGS

The bankruptcy filings of crypto companies in 2022 were troublesome to individual investors who were ordinary consumers drawn by the popularity of a technology nuance.<sup>273</sup> They became creditors in a long and complicated legal process with little understanding of how to recover their investment.<sup>274</sup> In a bankruptcy proceeding, the classification of crypto affects whether those consumer creditors can continue recovering their money after the proceeding’s end by asserting a discharge exception. Classifying cryptocurrency strictly as a commodity closes the door for those individuals to qualify for a discharge exception based on crypto-related securities law violations. Because of this, bankruptcy courts and legislators alike should consider the characteristics of the cryptocurrency involved before making critical legal or policy decisions.

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the discrimination; (3) the discrimination is proposed in good faith; and (4) the degree of the discrimination is directly related to the basis or rationale for the discrimination.”).

268. See WARREN ET AL., *supra* note 218, at 630–31; 11 U.S.C. § 1129(b)(2)(B).

269. See WARREN ET AL., *supra* note 218, at 630.

270. *Id.*

271. Bank of Am. Nat’l Tr. & Sav. Ass’n v. 203 N. LaSalle St. P’ship, 526 U.S. 434, 444 (1999).

272. *Id.* (citation omitted).

273. See Becky Yerak & Akiko Matsuda, *For Crypto Customers, a Long Battle Ahead in Bankruptcy*, WALL ST. J. PRO BANKR. (Aug. 1, 2022), <https://www.wsj.com/articles/for-crypto-customers-a-long-battle-ahead-in-bankruptcy-11659379620> (last visited Mar. 6, 2024).

274. *Id.*

A 2023 bankruptcy court memorandum illustrates the difficult position of the consumer creditors and offers an example for analysis.<sup>275</sup> In the memorandum, the Southern District of New York Bankruptcy Court addressed the ownership issue concerning cryptocurrency assets deposited in Celsius’s user accounts, known as “Earn Accounts,” which had a market value of approximately \$4.2 billion right before the company filed its bankruptcy petition.<sup>276</sup> The court concluded that the crypto assets deposited in those accounts were properties of Celsius and thus became the property of the bankruptcy estate.<sup>277</sup> The account holders disagreed and argued that they should be considered as the asset owners instead, but the court deemed them to be unsecured creditors.<sup>278</sup> Their recovery “depend[ed] on the distributions to unsecured creditors under a confirmed chapter 11 plan, or under the Bankruptcy Code’s priority rules.”<sup>279</sup>

The court emphasized that a “fundamental principle of the Bankruptcy Code is equality of distribution”: because there is simply not enough money available to repay all account holders in full, the court is unwilling to let some users prevail as owners of crypto assets while most users are left as unsecured creditors recovering only a small percentage of their claims.<sup>280</sup> While the precise amount of allowed unsecured claims is subject to later determination, such amount may include damages asserted based on theories of liability, including fraud.<sup>281</sup> Nevertheless, the unsecured creditors—the account holders who are likely individual consumers—have to face the reality of recovering pennies on the dollar. This will not be a unique phenomenon in the wave of crypto bankruptcies.

It is likely that the account holders are general unsecured creditors who deposited money into their Celsius accounts, meaning that they receive distributions only after the unsecured creditors listed in Bankruptcy Code Section 507.<sup>282</sup> What other measures do the account holders have to recover more of their claims? The following analysis offers a few

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275. *In re Celsius Network LLC*, 647 B.R. 631 (Bankr. S.D.N.Y. 2023).

276. *Id.* at 636–38.

277. *Id.* at 637. The court opined that the issue of ownership is a contract law issue: there was a provision in Celsius’s Terms of Use stating that the company held “all right and title to such Eligible Digital Assets, including ownership rights,” *id.*, in the user accounts, and this language should control. *Id.* at 637–40. Being a clickwrap contract, the Terms were accepted by almost all of the Celsius users. *Id.* at 637. See *supra* section III.A for an explanation of the bankruptcy estate.

278. *In re Celsius*, 647 B.R. at 637. See *supra* section III.A for an explanation of the different treatment of creditors in a bankruptcy proceeding.

279. *In re Celsius*, 647 B.R. at 637–38. See *supra* section III.B for information on Chapter 11 bankruptcy and *supra* section III.A for priority rules.

280. *In re Celsius*, 647 B.R. at 638.

281. *Id.* at 651.

282. 11 U.S.C. § 507; see also *id.* § 726 (setting the baseline distribution order).

predictions and shows that the individual creditors may favor classifying crypto as securities.

Foremost, because Chapter 11 involves a plan confirmation process,<sup>283</sup> the individual creditors have the power to vote no on the plan and continue negotiating with the debtor. However, Celsius, like any debtor entity, always has the option to “cramdown” any objections and have the court confirm the plan.<sup>284</sup> The Code lists out specific requirements for cramming down unsecured creditors,<sup>285</sup> but a plan confirmation without paying the unsecured creditors in full is likely.<sup>286</sup> Once confirmed, the plan is binding on the debtors, all associated entities, and creditors.<sup>287</sup> A breach of the confirmed plan is an action in contempt of court.<sup>288</sup> Most importantly, the debtor is discharged from any debt that arose before the date of such confirmation.<sup>289</sup> This means that the crypto account holders, as an unsecured creditor class, face the possibility of being forced into the plan’s terms without other ways to recover after the plan confirmation. If they only recover a low percentage of their claims, that will be the end.

Nevertheless, a plan confirmation does not have to be the end. Individual creditors can potentially avoid a discharge of their debt without much recovery if they can successfully prove an exception.<sup>290</sup> If the debt can be characterized as an exception to a bankruptcy discharge, the account-holder creditors can keep their claims and eventually seek resolutions, either from the debtor or through other legal means outside of bankruptcy.<sup>291</sup> The Bankruptcy Code provides a list of exceptions to discharge, among which is Section 523(a)(19): when any debt is for the

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283. See *supra* section III.B for rules on creditor voting in a Chapter 11 case.

284. See *supra* section III.B for explanation on cramdown.

285. 11 U.S.C. § 1129(b)(2)(B).

286. See *id.* In order to confirm the plan over a creditor class’s “no,” the Code requires the plan to be “fair and equitable” under Section 1129(b)(2). The Code then provides conditions under which the plan is deemed fair and equitable. See *id.* § 1129(b)(2). With respect to unsecured claims, the plan either pays those claims in full, or adheres to the “absolute priority rule.” See *id.* § 1129(b)(2)(B); *supra* section III.B. The former is more straightforward, but the latter is the situation where unsecured creditors are not paid in full, but no one with lower priority is entitled to receive any distribution. See *supra* section III.B. In other words, the unsecured creditors are the last stop for distribution. See *supra* section III.B.

287. 11 U.S.C. § 1141(a).

288. See Lance P. Martin, *Use Clarity to Avoid Contempt in Bankruptcy*, WARD & SMITH, P.A. (Sept. 8, 2021), <https://www.wardandsmith.com/articles/use-clarity-to-avoid-contempt-in-bankruptcy> [<https://perma.cc/74SN-DW8H>] (“Bankruptcy courts have the power to hold a party in civil contempt and to impose sanctions for violation of a confirmed plan.”).

289. See *supra* section III.A.

290. See *supra* section III.B.

291. See *supra* section III.B.

violation of any federal securities laws or common law fraud in connection with the purchase or sale of any security.<sup>292</sup>

Any creditor in a bankruptcy proceeding can bring discharge exceptions to the court's attention through an adversary proceeding.<sup>293</sup> For a party to initiate an adversary proceeding arguing non-discharge under Section 523(a)(19), that party has the burden of showing the *prima facie* elements,<sup>294</sup> which include showing that the debt is indeed in connection with a "security."<sup>295</sup> As individuals who entrusted the cryptocurrency companies and purchased digital assets, the account-holder creditors most likely have claims in connection with a "security" if cryptocurrency falls within the category. In other words, the classification of cryptocurrencies becomes relevant to how crypto account holders—individual consumers as creditors—can recover their interests. The question of whether cryptocurrencies can be characterized as securities carries practical consequences.

The Digital Commodities Consumer Protection Act defines a new asset category called "digital commodity," which explicitly encompasses cryptocurrencies such as Bitcoin.<sup>296</sup> Considering the rising popularity of cryptocurrency and digital asset trading, the bill serves an important and necessary purpose of providing the Commodity Futures Trading Commission jurisdiction for oversight.<sup>297</sup> In doing so, the bill seems to solidify the conception that cryptocurrencies are commodities—specifically digital commodities. Indeed, courts in the past have classified cryptocurrencies, specifically Bitcoin, as commodities.<sup>298</sup> However, generalizing cryptocurrency as a commodity could have a particular impact on consumer crypto account holders who are seeking recovery of their claims. If cryptocurrency is straightforwardly considered a commodity, such classification takes away an opportunity for consumer creditors to seek a non-discharge on their claims under Bankruptcy Code Section 523(a)(19), pushing them closer to accepting a plan that provides them pennies on the dollar.

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292. 11 U.S.C. § 523(a)(19). See *supra* section III.A for more detail on discharge.

293. See *supra* section III.A; 11 U.S.C. § 523. An adversary proceeding is a procedure construct when a bankruptcy case is ongoing and is typically used to resolve claim disputes, including proceedings to determine the dischargeability of a debt. FED. R. BANKR. P. 7001.

294. FED. R. BANKR. P. 4005 ("At the trial on a complaint objecting to a discharge, the plaintiff has the burden of proving the objection.").

295. 11 U.S.C. § 523(a)(19).

296. Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. § 2(a)(2) (2022). See *supra* section II.C for background on the Act and the definition of "digital commodity."

297. See *supra* section II.C for more information on the Act.

298. See *supra* section II.A for more case illustrations.

The Digital Commodities Consumer Protection Act does not prohibit the classification of cryptocurrency as a security. It defines “digital commodity” in a way that does not include “a security.”<sup>299</sup> The proposed legislation does not exclusively define cryptocurrency as a digital commodity. Case law has demonstrated that when courts face such a classification issue, there is a specific test—the *Howey* test—available to determine whether certain cryptocurrency transactions should be treated as securities transactions.<sup>300</sup> The classification issue itself is not new, and the rich precedent from securities law litigations sheds light on how the legal system should treat cryptocurrency. While untangling the recent crypto company bankruptcies, bankruptcy courts should avoid conclusive classification of cryptocurrency as a commodity and consider its classification as a security.

Alternatively, since Congress has proposed to define “digital commodity” as a new asset category, this asset category should have a presence in the Bankruptcy Code. The bankruptcy system revolves around finding and distributing assets to creditors equitably,<sup>301</sup> but most importantly, it incorporates and reflects Congress’s policy considerations. It is necessary to respect the rights of individual creditors in a crypto bankruptcy case who are vulnerable consumers and likely without many resources. Congress should amend the Bankruptcy Code to protect those individuals. Specifically, Congress should consider adding a provision to Section 523(a) of the Bankruptcy Code, granting an exception to discharge associated with digital commodities, mimicking the current provisions under Section 523(a)(19) in connection with securities regulations.

The year 2022 was a frantic year for investors in cryptocurrency. The bankruptcy filings of notable participants in the crypto market were a harsh blow to investors’ confidence. Most significantly, those filings were troubling news to ordinary consumers who became creditors in a process they likely do not understand. While those consumer creditors are bearing the consequences of their own financial decisions, they should not be denied opportunities for redress in a system that gives great consideration to fairness and justice.

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299. Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. § 2(18)(C)(ii) (2022).

300. See *supra* section II.B.

301. See *supra* section III.A for an introduction to the bankruptcy system.

## CONCLUSION

Whether cryptocurrency should be considered a commodity or a security has been debated since its entrance to the market. This debate has implications in bankruptcy proceedings, specifically in connection with the means available to creditors to recover their claims. In a bankruptcy proceeding, an unsecured creditor faces the possibility of recovering only pennies on the dollar and having their debt discharged. Once there is a discharge, the creditor no longer has the ability to seek further payments from the debtor. Nevertheless, a creditor can show that their claim falls within an exception to discharge and thus maintain their claim after the conclusion of a bankruptcy case. The creditor then has legal measures outside of bankruptcy to obtain remedies from the debtor, potentially recovering their full claim.

The proposed Digital Commodities Consumer Protection Act seems to define cryptocurrency as a commodity. This definition, however, creates a danger of generalization. Classifying cryptocurrency as a commodity effectively limits an unsecured creditor's ability to use Section 523(a)(19), an exception to discharge debt related to violations of federal securities laws and transactions involving securities. In the recent crypto bankruptcy cases filed by prominent participants in the crypto market, many creditors are individual customer account holders who likely have limited legal knowledge. Disregarding cryptocurrencies' resemblance to securities closes the door for those consumer creditors to obtain a non-discharge under the Bankruptcy Code in hope of recovering more of their claims outside of bankruptcy. If the Digital Commodities Consumer Protection Act passes, bankruptcy courts should not generalize cryptocurrency as a commodity, and Congress should consider amending the Bankruptcy Code, creating a new exception to discharge for digital commodity transactions involving consumers.

