

# Is Cryptocurrency Use an Automatic Badge of Fraud?

BLOCKCHAIN AND DIGITAL CURRENCY | CRYPTO INSOLVENCY AND FIDUCIARY PRACTICE |  
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Creditors and trustees may use state or federal fraudulent transfer law to attempt to recover assets transferred by a debtor. Fraudulent transfers are transfers made with the intent to hinder, delay, or defraud a creditor, or without receiving reasonably equivalent value in exchange under certain circumstances. Fraudulent conveyance actions are a frequently used tool of bankruptcy trustees and creditors.<sup>[1]</sup> Fraudulent transfers may include transfers that are actually or constructively fraudulent. Actual fraud involves a party intentionally transferring an asset to a third party and ostensibly beyond the reach of the transferor's creditors. Constructive fraud looks to the circumstances of transfers made while the transferor was insolvent to determine if the transferor received less than reasonably equivalent value in exchange for the transfer. Successful creditors or fiduciaries may recover the thing transferred or its value, subject to certain defenses available to transferees.

To determine whether a transaction is actually, as opposed to constructively, fraudulent requires consideration of the transferor's intent. Because parties who engage in purportedly fraudulent transfers may not openly admit that their intent is to defraud their creditors, the law considers certain circumstantial facts to be "badges of fraud" from which fraudulent intent may be inferred. These badges of fraud include, among others, whether a transfer was concealed or whether a debtor/transferor concealed assets. See, e.g., Fla. Stat. § 726.105(2)(c), (g) (2019).

Given that crypto assets create different types of records than traditional financial instruments like fiat money, and are subject to different regulations than those traditional financial instruments, could cryptocurrency use itself be or become a "badge of fraud"?

Despite increasingly outdated notions that cryptocurrencies are only useful for illicit transactions, the use of cryptocurrencies for a variety of transactions is clearly becoming more commonplace. Many businesses offer products and services that accept or use cryptocurrencies and, although not widespread, many significant vendors and service providers transact in cryptocurrencies. The financial services and investment communities have embraced various cryptocurrency and DeFi systems. Therefore, the control or use of cryptocurrency alone should not be indicative of fraudulent intent. The trier of fact should consider and rely on the factual circumstances surrounding the control and use of the cryptocurrency in the transfers at issue to determine any fraudulent intent.

Because the court's analysis of badges of fraud is fact- and context-specific, differences in circumstances could influence the court's determination of how the fact of cryptocurrency use is treated. For example, if a debtor, who never showed interest in technology, converts all her assets into a privacy-enabled cryptocurrency days after taking on significant debt, and sends the currency to a party who cannot be identified, the circumstances likely suggest the cryptocurrency was used with fraudulent intent to evade creditors. Such a transaction would implicate numerous badges of fraud, including concealing the assets and the identity of the transferee recipient(s), who could be an insider of the debtor. On the other hand, if a technology entrepreneur had accumulated substantial cryptocurrency holdings and used those holdings to satisfy obligations owed to others who also regularly engage in commerce using cryptocurrencies, or for investment purposes, the mere fact that cryptocurrencies were used would probably not indicate an intent to conceal or defraud creditors. Context is critical.

Based on the above analysis, cryptocurrency control or use should not automatically be considered a badge of fraud. Still, cryptocurrency use will almost certainly complicate certain aspects of investigating or evaluating asset transfers. Debtors may be attracted to cryptocurrencies by their complexity. For this reason, a creditor should employ professionals experienced with

crypto when pursuing collection from high net worth debtors.

Cryptocurrencies use their own novel transfer systems and create different types of records of their acquisitions and transactions than traditional financial instruments, which can complicate tracing these assets. Parties to transfers of cryptocurrencies are not identified as easily as parties to other asset transfers, like bank wires. Some crypto assets may be obtained from identifiable third parties in exchange for easily identified payments of fiat currency, while others may be obtained by nonfinancial conduct or not pass through legally identifiable intermediaries.

Creditors and fiduciaries seeking to recover crypto assets should retain counsel who understand the nuances of these new asset types and can respond quickly. Contact Carlton Fields' Crypto Insolvency and Fiduciary Practice to discuss the legal implications of transfers involving crypto assets, and how we can help creditors and fiduciaries recover.

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[1] Sections 548 and 550 of the U.S. Bankruptcy Code authorize trustees and debtors in possession to avoid and recover fraudulent transfers by a debtor made during a certain period before the commencement of the bankruptcy case, usually between two and six years. All 50 states have enacted some form of similar laws. Florida, for example, in chapter 726 of the Florida Statutes, authorizes creditors to avoid and recover fraudulent transfers.

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