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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

The Ill-Fated Emergence Of The Bitcoin Balance Sheet

By **John Reed Stark** (November 25, 2020, 4:02 PM EST)


John Reed Stark

This year MicroStrategy relished in a good problem to have — a half a billion dollars of cash in its bank account and uncertainty over what to do with it. The company could have paid its shareholders a hefty dividend, bought back a truckload of its stock, invested in research and development, financed new acquisitions or pursued other traditional financial endeavors.

But the Nasdaq-traded tech firm got creative, and instead opted to buy $425 million worth of Bitcoin,[1] converting what MicroStrategy called its "primary treasury reserve asset" into Bitcoin.[2]

Just visit the Bitcoin information link on MicroStrategy's website and read all about MicroStrategy's Bitcoin gambit.[3] The site contains a slew of Bitcoin-related promotional media, and a slew of video interviews from various newscasts and podcasts featuring MicroStrategy's colorful CEO, Michael Saylor, waxing poetic on the wonderment of Bitcoin investing.

Yes, that's right, they are brazenly hyping Bitcoin, the computer-generated chattel that dwells amid a sinister and underground economic realm of competing bandits. Hence the genesis of the Bitcoin balance sheet, and, in my opinion, a new chapter of shameful, reckless and irresponsible corporate behavior.

A New Low

Consider first and foremost what the U.S. Department of Justice has identified as cryptocurrency's most notorious uses:[4] money laundering, ransomware, terrorism, illicit drug, gun and child pornography sales, and the list goes on. That is why, ironically, one of Bitcoin's most convenient criminal attributes is its use for the theft of other bitcoin.

By elevating Bitcoin profiteering into a core businesses line, MicroStrategy is not only facilitating a new brand of corporate harm, but also staging a rather poor example of corporate environmental, social and corporate governance[5] to say the least.

Consider also Bitcoin's unregulated marketplace, replete with: rampant manipulation;[6] wild price volatility;[7] pervasive cybersecurity vulnerabilities;[8] hidden tax and capital gain burdens;[9] and other entanglement mishaps.[10] Indeed, Bitcoin's anarchistic valuations remain generally unregulated and without any meaningful oversight, leaving them easily susceptible to fraud and chicanery by insiders, management and better-informed traders and market participants.

If there is any doubt relating to the perils of MicroStrategy's Bitcoin foray, look no further than MicroStrategy's own risk factors[11] set forth in its Sept. 30 quarterly filing with the U.S. Securities and Exchange Commission.[12] The risk factors highlight dangers associated with Bitcoin's price volatility, less liquidity, and lower trading volumes; Bitcoin's overall "regulatory, commercial and technical" uncertainty; and Bitcoin's "susceptibility to market abuse and manipulation."[13]

Even more ominous are the risk factors relating to the cybersecurity of Bitcoin accounts, such as "security breaches, cyberattacks, or other malicious activities," which "could result in a partial or total loss of our bitcoins in a manner that may not be covered by insurance or indemnity provisions of our custody agreements with those custodians."[14]

Déjà Vu All Over Again

MicroStrategy's Bitcoin journey is also eerily reminiscent of when Procter & Gamble Co. and Gibson Greetings Inc. lost a reported $200 million and $20 million respectively in the 1990s by investing in complex and risky derivatives products. I was working at the SEC's enforcement division at the time, and what struck me back then was how the company executives, at the cajoling of Bankers Trust Co., failed miserably in their attempt to turn their respective corporate treasury departments into profit centers. The same could someday be said for MicroStrategy's Bitcoin venture.

By financially engineering their treasury reserves as both hedge and profit center, MicroStrategy is following in the footsteps of P&G and Gibson Greetings, who, 25 years ago, tried to do the same with derivatives. Unfortunately, just like P&G and Gibson Greetings, MicroStrategy is investing in complex instruments that they do not understand; that experience routine extreme price volatility and liquidity pressures; and that trade in a financial environment that is not at all understood or closely monitored by regulators.

PTSD and The Bankers Trust Tapes

As part of a private lawsuit filed by P&G, Bankers Trust was forced to turn over some 6,500 tapes of recorded conversations.[15] The inculpatory evidence of the tapes was mesmerizing.[16] The tapes recorded the trader who sold P&G two derivatives contracts, saying, "It's like Russian roulette, and I keep putting another bullet in the revolver every time I do one of these."[17] No doubt that similar conversations could be overheard among the unregulated, so-called "bitcoin traders." Only this time, those conversations are not recorded. In fact, recording them is next to impossible, because those communications are often kept secret via the encrypted texts used by bitcoin promoters to conspire over the dark web.[18]

Warren Buffett, whose use of derivatives has always been begrudging, commented extensively on the P&G, Gibson Greetings debacle in his 2002 Berkshire Hathaway annual report, stating: "I view derivatives as time bombs, both for the parties that deal in them and the economic system ... derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal."[19]

Today, Buffett admonishes a similar refrain regarding Bitcoin, labeling cryptocurrency "rat poison squared ... [y]ou can't do anything with it except sell it to somebody else."[20]

Beyond MicroStrategy

It remains to be seen whether other corporations will follow MicroStrategy's lead. Given COVID-19 bailouts, some companies may believe a Bitcoin strategy somehow hedges against inflation and can serve as safe haven from any coronavirus recession.[21] Ironically, some also recognize Bitcoin as a crypto-bridge play, because Bitcoin acts as a "bridge cryptocurrency" for buying less common cryptocurrencies.[22]

But corporate bitcoin gamblers are arguably ascribing to the greater fool theory, betting that there will always be a greater fool poised to pay a higher price, and to some experts,[23] that sort of gameplay is akin to buying tulips in 1637.[24] Moreover, an investment whose appreciation is primarily dependent on whether someone else is willing to pay a higher price for it is rarely a suitable investment for anyone, especially a corporation. Thus, in the event of a Bitcoin crash, these corporations (and their officers and directors) could face debilitating class actions and derivative actions.

While corporate investing in Bitcoin might not rise to the level of fraud, some view wagering on Bitcoin as profiting from the acts of terrorists, extortionists, drug dealers and the rest of the iniquitous dark web.[25] Such irresponsible corporate investing seems wholly inconsistent with, and in stark contrast to, a company's fiduciary duty to shareholders.

Finally, despite what a company warns in the risk factors of its SEC filings, the values of digital assets like Bitcoin are not connected or correlated to traditional economic or market forces, and can decline rapidly, including to zero. Along these lines, disclosing away the known perilous risks associated with a Bitcoin-centric corporate investment plan will always present challenges.

Looking Ahead

Conceivably, the blockchain technology on which Bitcoin is based could turn out to be the most exciting, disruptive, transformative and efficiency enhancing breakthrough since sliced bread. But in the meantime, and aside from complex issues[26] of privacy,[27] security,[28] ethics[29] and simple practicality, blockchain technology remains embryonic; has still yet to be proven;[30] and happens to operate within an economic ecosystem rife with fraud, deceit, dishonesty and thievery.

Bitcoin is probably blockchain's most celebrated accomplishment, yet much of Bitcoin's value, outside of mere speculation, derives from its ability to facilitate criminal activity.

My take is that financial mechanisms and practices promoted by self-anointed fintech professionals extolling the "new blockchain economy" have no place in corporate treasury departments. Indeed, given how far astray Bitcoin hedging is from its business of building "intelligent business platforms," perhaps MicroStrategy should retask itself as an investment company and register with the SEC.

But then again perhaps not. Given the SEC's current cryptocurrency crackdown,[31] and the fact that MicroStrategy's CEO personally bought 17,732 bitcoin[32] before MicroStrategy bought its 38,250 bitcoin, inviting further federal regulatory scrutiny is probably the last thing that MicroStrategy has in mind.

John Reed Stark is the president of John Reed Stark Consulting LLC.

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