Cryptocurrency and Blockchain Litigation and Regulatory Enforcement

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This practice note describes the state of regulation and other law governing blockchain-based products, including cryptocurrency. Blockchain applications, including cryptocurrencies, present a host of new opportunities for businesses of all kinds, from entrepreneurs seeking to raise capital to traders looking for the next market. As with any new product, however, the regulatory landscape for cryptocurrencies is still developing, and legal and regulatory pitfalls abound. Regulators are debating whether to create new rules designed for these novel concepts or whether the old rules can be applied.

In the meantime, the current system of regulation—already arguably a regulatory patchwork involving an alphabet soup of agencies with overlapping mandates—leaves a number of uncertainties. This regulatory uncertainty only raises the risk of litigation and state and federal regulatory enforcement in the space. Indeed, the first wave of litigation and enforcement has already begun, with the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), various state attorneys general, and private plaintiffs leaping in to protect what they each view as governing law or to right alleged wrongs. While the final regulatory framework remains unclear, practitioners in this space should be aware of the current status of regulation and case law to properly advise clients and structure transactions. This note provides such a general background.

For practical guidance on the processes discussed in this note, see:

- Registered Offerings: Applicable Laws, Rules, and Regulations
- Insider Trading Claims: Defenses
- Regulators: SEC, FINRA, and PCAOB
- Liability under the Federal Securities Laws for Securities Offerings

WHAT IS BLOCKCHAIN?

Most of the litigation to date has involved one aspect of blockchain applications: cryptocurrency. In a way, this is sensible. Blockchain, after all, is merely a technology—a way of recording information on a distributed ledger in order to “disintermediate” transactions of information. A blockchain is a type of distributed ledger, or peer-to-peer database spread across a network, that records all transactions in the network in theoretically unchangeable, digitally recorded data packages called blocks. Each block contains a batch of records of transactions, including a time stamp and a reference to the previous block, linking the blocks together in a chain. The system relies on cryptographic techniques for secure recording of transactions. A blockchain can be shared and accessed by anyone with appropriate permissions.

Blockchain applications are being introduced as a "back office" mode of operation to improve efficiency in a host of different areas: supply chain management, tracking bundles of intellectual property rights, recording real estate transactions, and other quintessentially information science applications. Blockchains or distributed ledgers can also record what are known as smart contracts, essentially computer programs designed to execute the terms of a contract when certain triggering conditions are met.

POTENTIAL OF BLOCKCHAIN AND CRYPTOCURRENCY

While cryptocurrency is only one of many blockchain applications, it garners by far the most regulatory attention, as movement of currency, securities, and commodity futures are heavily regulated areas, in a way that (say) recording the present position of a shipment of physical goods is not.

The Financial Action Task Force defines cryptocurrency (in its terminology, a "virtual currency") as:

> a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency," "real money," or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.

Even outside cryptocurrency applications, blockchain technologies have the potential to revolutionize financial technology. In testimony to the Senate Banking Committee, the chair of the SEC, Jay Clayton, was particularly optimistic that "developments in financial technology will help facilitate capital formation," which will enable the SEC—and market participants—to better monitor transactions, holdings, and obligations (including credit exposures), and other market activities. Christopher Giancarlo, chair of the CFTC, emphasized in his testimony that blockchain technology may someday solve the "age-old 'double-spend' problem"—the need for "a trusted, central authority to ensure that an entity is capable of, and does, engage in a valid transaction."

Both stressed that cryptocurrency and blockchain-based markets were in their infancy, and still quite small compared to the larger markets as a whole. The chairmen observed that at the time, the market capitalization of bitcoin was not even the size of a single large-cap business like McDonald's, and the total value outstanding of all virtual currencies was about $365 billion—compared to, for example, about $8 trillion for the total value of gold. As an asset class, then, cryptocurrency is punching above its weight in terms of the publicity, compared to its relative size.

However, both chairmen saw a lot of promise to distributed-ledger technologies, including in far-flung fields such as smart contracts, transactional efficiencies arising from disintermediated financial transactions, and even refugee tracking. Mr. Giancarlo noted that one advantage of a distributed ledger technology is better access to information, and hypothesized that if markets had real-time information available on a distributed ledger about their credit exposures in 2008, different decisions might have been made during that financial crisis.

BIRTH OF BITCOIN AND THE GROWTH OF CRYPTOCURRENCIES

In November 2008, a person or persons using the name Satoshi Nakamoto wrote "Bitcoin: A Peer-to-Peer Electronic Cash System," in which Nakamoto described a "purely peer-to-peer version of electronic cash" that

"would allow online payments to be sent directly from one party to another without going through a financial institution." The primary advantage, the paper stated, was to avoid the necessity of a trusted third party to verify transactions and prevent double-spending.

The solution, in essence, was to distribute a cryptographically secured ledger containing the transactions to every "node" on the "network" (i.e., everyone with access to the ledger (which could be anyone)) so that anyone could see the entire chain of transactions and verify them. The bitcoin blockchain is thus an example of a "non-permissioned," or public and open access blockchain. Anyone can download the bitcoin open-source software and join.

Bitcoin was then "released" in a manner such that anyone could "mine" bitcoin—creating a new bitcoin that they can keep—by solving a certain computationally intensive mathematical problem. Because bitcoin was not created as a way of raising funds for a venture (apparently), the SEC does not consider it a security. A few other coins have been issued this way.

However, a host of variant cryptocurrencies have been issued. Most, unlike bitcoin, are looking to raise capital (usually, but not necessarily, for a blockchain-related product), and offer purchasers a unique "coin" or "token" in exchange for consideration. The tokens are issued on a blockchain—generally a "permissioned" or private blockchain, which requires servers to be approved to participate on the network.

THE LANDSCAPE FOR TOKEN OFFERINGS

From 2014 through 2016, the sale of cryptocurrency by start-ups to fund businesses and investments raised roughly $300 million. In 2017 alone, start-ups raised over $3 billion through initial coin offerings (ICOs), with over $1 billion of that amount coming in after September.

ICOs have attracted a great deal of scrutiny from regulators. In his Senate testimony, Mr. Clayton stated that most ICOs have not complied with the securities laws. "Simply calling something a currency or a currency-based product does not mean that it is not a security," he said. "If it functions as a security, it is a security." Prospective purchasers are being sold, he explained, on the potential for tokens to increase in value by reselling the tokens on a secondary market or to otherwise profit from the tokens based on the efforts of others, which are "key hallmarks of a security and a securities offering." As he put it, ICOs should be "regulated like securities offerings—end of story."

Further, in a "note for professionals," Mr. Clayton warned that "those who exercise semantic gymnastics to avoid having a coin being a security are squarely in the crosshairs of our enforcement division." He told Senator Elizabeth Warren of Massachusetts that there are gatekeepers who have "not done their job," once again sounding a warning bell for professionals—lawyers, accountants, underwriters, promoters (including celebrity endorsers), sellers, and the like.

Despite Mr. Clayton's harsh words, so-called "alternative coins" or "alt coins" have flourished, and many are traded on foreign or domestic exchanges that are also operating with questionable U.S. regulatory authority. Further, an ecosystem of traders has arisen: individuals, family offices, and even funds with outside investors.

Accordingly, regulators face a challenging task. In their own words, an entire ecosystem is operating in violation of the securities or commodities laws. But a full-scale press to remediate every violation would endanger a multibillion dollar industry and threaten to quash a promising technology still in its infancy. Thus, the pronouncements from the regulators to date have walked a very narrow path.

REGULATORY ENVIRONMENT – MAJOR PRONOUNCEMENTS TO DATE

The SEC

The SEC has concluded that virtually all—if not all—ICOs that it has seen were securities offerings, because all the coins or tokens offered through them were securities. For that reason, the SEC has posited that it has regulatory jurisdiction over all cryptocurrency (with the exception of bitcoin, and perhaps some limited others).

On July 25, 2017, the SEC issued an investigative report concluding that tokens issued by a company called The DAO were under the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act). The SEC advised those who would use a “distributed ledger or blockchain-enabled means for capital raising, to take appropriate steps to ensure compliance with the U.S. federal securities laws.” In the SEC’s view, “the automation of certain functions through this technology, ‘smart contracts,’ or computer code, does not remove conduct from the purview of the U.S. federal securities law.” The SEC cited SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943):

> [T]he reach of the [Securities] Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as “investment contracts,” or as “any interest or instrument commonly known as a ‘security.’”

As set forth in The DAO report, the most cited case to defend the idea that cryptocurrencies are securities is SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946), which sets out the Supreme Court’s definition of investment contracts, a type of security: an investment contract that is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. As noted in *Howey*, this definition embodies a “flexible rather than a static principle, one that 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.”

The SEC also warned platforms that traded DAO tokens that they did not appear to have satisfied Rule 3b-16(a). 17 C.F.R. § 240.3b-16(a). That is, the platforms did not satisfy the definition of an exchange under the Exchange Act, and they did not appear to have met any exclusions (such as under Rule 3b-16(b) or Regulation ATS).

The SEC followed up The DAO report with an August 28, 2017, investor alert warning about companies making ICO-related claims, noting that it had begun to issue “trading suspensions on the common stock of certain issuers who made claims regarding their investments in ICOs or touted coin/token-related news,” such as First Bitcoin Capital Corp., CIAO Group, Strategic Global, and Sunshine Capital.

Additional market warnings followed, including:

- A November 1, 2017, statement urging caution around celebrity-backed ICOs (warning about the rising use of celebrities to tout coins in violation of securities laws)
- A December 11, 2017, statement on cryptocurrencies and initial coin offerings (setting forth Mr. Clayton’s view that while ICOs “can be effective ways for entrepreneurs and others to raise funding, including for innovative projects,” “any such activity that involves an offering of securities must be accompanied by the important disclosures, processes, and other investor protections that our securities laws require”)
- A January 19, 2018, joint statement from the SEC and CFTC enforcement directors (warning that “when market participants engage in fraud under the guise of offering digital instruments—whether characterized

as virtual currencies, coins, tokens, or the like—the SEC and the CFTC will look beyond from, examine the substance of the activity, and prosecute violations of the federal securities and commodities laws")

- A January 25, 2018, Wall Street Journal op-ed by Mr. Clayton and Mr. Giancarlo
- Testimony by Mr. Clayton before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on "Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission"
- A March 7, 2018, statement on potentially unlawful online platforms for trading digital assets (warning again about the trading platforms or exchanges on which cryptocurrencies were and are being traded publicly)

Somewhat amusingly, in May 2018, the SEC even put together a website touting "HoweyCoins," an imaginary cryptocurrency, as a way to alert investors to potential issues in ICOs.

In addition to its regulatory pronouncements, the SEC has brought a series of litigations and administrative proceedings (see the subsection "SEC" in Regulatory Enforcement and Litigation to Date), as well as sending scores (at least) of subpoenas to token issuers, exchanges, and other market players across the country in a significant, nationwide investigation. The SEC has also appointed its first "crypto-czar" (more formally, a "Senior Advisor for Digital Assets and Innovation"), Valerie Szczepanik, an extremely knowledgeable and experienced SEC attorney, to "coordinate efforts across all SEC Divisions and Offices regarding the application of U.S. securities laws to emerging digital asset technologies and innovations, including Initial Coin Offerings and cryptocurrencies."

The CFTC

The CFTC has taken the view that while cryptocurrency may be a security, it is a commodity as well. Mr. Giancarlo said in his own written testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs that "the CFTC does not have regulatory jurisdiction under the [Commodities Exchange Act] over markets or platforms conducting cash or 'spot' transactions in virtual currencies or other commodities or over participants on such platforms." More specifically, the CFTC does not have authority to conduct regulatory oversight over spot cryptocurrency platforms or other cash commodities, including imposing registration requirements, surveillance and monitoring, transaction reporting, compliance with personnel conduct standards, customer education, capital adequacy, trading system safeguards, cyber security examinations, or other requirements.

However, while the CFTC does not have jurisdiction to regulate spot market trading in cryptocurrency, it does regulate U.S. exchanges for any commodities and their futures or derivatives. It also asserts authority under Section 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. § 9(1), and Regulation 180.1, 17 C.F.R. § 180.1, to regulate fraud in the spot markets for commodities (and, more controversially, whether or not those commodities have traded futures or derivatives).

Like the SEC, the CFTC has also issued a series of pronouncements and guidance for investors and traders, starting with A CFTC Primer on Virtual Currencies, and including:

- A December 1, 2017, CFTC backgrounder on self-certified contracts for bitcoin products
- A December 15, 2017, customer advisory: understand the risks of virtual currency trading and release on retail commodity transactions involving virtual currency
- A January 4, 2018, CFTC backgrounder on oversight of and approach to virtual currency futures markets
- A February 15, 2018, customer advisory: beware virtual currency pump-and-dump schemes

- A May 21, 2019, advisory with respect to virtual currency derivative product listings

FinCEN

The Treasury Department's Financial Crimes Enforcement Network (FinCEN) has jurisdictional authority over financial crimes and other activity involving the transmission of currency. FinCEN believes that if a company or individual is moving money as a business, certain regulations apply, certain licenses are required, and certain steps must be taken to ensure compliance with anti-money laundering regulations.

As far back as March 2013, FinCEN issued guidance on the application of FinCEN's regulations to transactions in virtual currencies. In January 2014, FinCEN issued additional guidance regarding applying its regulations to Virtual Currency Mining Operations.

FinCEN followed this guidance with a series of administrative rulings, on:

- The Definition of User in Context of Mining (January 2014)
- The Definition of User in Context of Software Development and Investing in Virtual Currencies (January 2014)
- Rental of Computer System for Mining Virtual Currency (April 2014)
- Virtual Currency Trading Platforms, in response to a request that a certain unnamed company engaged in bitcoin transactions was thereby engaged in money transmission, and thus FinCEN's regulations applied (October 2014)
- Virtual Currency Payment Systems (October 2014) –and–
- Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals (August 2015)

In February 2018, FinCEN sent a letter to Senator Rob Wyden (the ranking member of the Senate Finance Committee) setting forth its oversight and enforcement capabilities over virtual currency financial activities, and in August 2018, FinCEN Director Kenneth Blanco delivered remarks at the 2018 Chicago-Kent Block (Legal) Tech Conference reiterating the various regulatory activities being undertaken by FinCEN.

FINRA

The Financial Industry Regulatory Authority (FINRA), a self-regulatory organization of member brokerage firms and exchange markets, has largely let the SEC take the lead. However, in its January 8, 2018, annual Regulatory and Examination Priorities Letter, FINRA stated that it will "will closely monitor developments in this area, including the role firms and registered representatives may play in effecting transactions in such assets and ICOs." And on July 6, 2018, FINRA encouraged firms to notify it if they engage in activities related to digital assets. It remains to be seen what role FINRA will play (if any) in cryptocurrency enforcement, but any such role is only likely to arise once SEC-regulated cryptocurrency exchanges and trading become more widespread.

New York State

On August 2015, New York State enacted virtual currencies regulations (NYCRR 23:200: Virtual Currencies (BitLicense Regulations)), a burdensome set of requirements for individuals and corporate entities (however organized) and their principal officers and shareholders, dealing with "virtual currency." The statute broadly defines virtual currency as any "type of digital unit that is used as a medium of exchange or a form of digitally stored value" (with certain narrow exceptions for virtual currencies solely within online games that cannot be redeemed for fiat currency).

The statute also defines "virtual currency business activity" quite broadly, including (where involving New York or a New York resident):

- Receiving virtual currency for transmission or transmitting virtual currency, except where the transaction is undertaken for nonfinancial purposes and does not involve the transfer of more than a nominal amount of virtual currency
- Storing, holding, or maintaining custody or control of virtual currency on behalf of others
- Buying and selling virtual currency as a customer business
- Performing exchange services as a customer business –or–
- Controlling, administering, or issuing a virtual currency

For any such person conducting any such activity, the statute requires a license. Unfortunately, New York has not made it easy to obtain a license, and relatively few have been issued to date. Further, New York's superintendent of financial services, Maria T. Vullo, released Guidance on Prevention of Market Manipulation and Other Wrongful Activity, which set forth further anti-fraud requirements for licensed virtual currency businesses, and requiring "immediate" reporting of any wrongdoing.

As a result of these relatively stringent policies and guidelines, New York has been viewed as a relatively more hostile jurisdiction for cryptocurrency businesses. That view was emphasized by the April 17, 2018, announcement by then-Attorney General Eric Schneiderman about an "inquiry into cryptocurrency 'exchanges,'" in which the New York attorney general issued a slew of investigatory requests to 13 trading platforms.

Wyoming and Arizona

Other states have taken different, more welcoming views. Wyoming, for example, has passed a series of blockchain-friendly measures, enacting:

- An exemption from money transmitter laws and regulation for virtual currency (e.g., bitcoin, Ethereum, etc.) used within Wyoming
- A provision that a person who develops, sells, or facilitates the exchange of an open blockchain token (a "consumer" or "utility" token) is not subject to specified securities and money transmission laws
- An act providing for the maintenance of corporate records of Wyoming entities via blockchain so long as electronic keys, network signatures, and digital receipts are used —and–
- An act providing that virtual currency is not subject to taxation as "property" in Wyoming

Arizona has enacted a law that supports corporate recordkeeping on the blockchain and another that creates a regulatory "sandbox" for start-ups to experiment at a reduced regulatory burden.

However, given that a particular money-transmission business (including cryptocurrency transmission) is unlikely to grow significantly while remaining strictly intrastate, states' blockchain-friendly regulations will have difficulty overcoming a harsher view by federal authorities.

REGULATORY ENFORCEMENT AND LITIGATION TO DATE

Against this regulatory background, various enforcement bodies have been litigating or filing administrative enforcement actions against violators.

Criminal Prosecutions by the Department of Justice

Outright frauds and violations of federal criminal law are likely to attract the attention of the DOJ. Indeed, the DOJ has applied traditional criminal law to the cryptocurrency arena, leaning on 18 U.S.C. § 1956 (money laundering) and 18 U.S.C. § 1960 (operation of an unlicensed money transmission business), alongside the more traditional and general 18 U.S.C. § 371 (conspiracy), 18 U.S.C. § 1343 (wire fraud), and 18 U.S.C. § 1349 (attempt and conspiracy).

The DOJ has pursued several such prosecutions successfully, including:

- U.S. v. Budovsky and Liberty Reserve, 2016 U.S. Dist. LEXIS 13050 (S.D.N.Y. Jan. 28, 2016), which ended in a final order of forfeiture and sentence of 20 years for laundering money through cryptocurrency
- U.S. v. Murgio, Lebedev, and Gross, 209 F. Supp. 3d 698 (S.D.N.Y. 2016), which ended in convictions of all defendants for illegal bitcoin transactions and money laundering, and a five-year prison sentence for one defendant
- U.S. v. Ong, 17-191-RSL (W.D.Wa., filed Aug. 16, 2017), which ended in a judgment of 20 days of incarceration and over $1 million in forfeiture
- U.S. v. Mansy and TV TOYZ, LLC, 2017 U.S. Dist. LEXIS 71786 (D. Me. May 11, 2017), which ended in a year-and-a-day prison sentence for defendant Mansy and a final order of forfeiture

Several other prosecutions are still pending, including U.S. v. Haddow, 17-cr-4939 (S.D.N.Y., filed June 29, 2017); U.S. v. Zaslavskiy, 17-cr-647 (E.D.N.Y., filed Oct. 27, 2017); U.S. v. Tetley, 17-cr-738 (C.D.Ca., filed Nov. 28, 2017); U.S. v. Montroll, 18-mag-1372 (S.D.N.Y., filed Feb. 20, 2018); U.S. v. Sharma and Farkas, 18-cv-02909 (S.D.N.Y., filed 4/2/18); U.S. v. Kantor, 18-cr-0177 (E.D.N.Y., filed 4/10/18); and U.S. v. Trapani, 18-mag-3271 (S.D.N.Y., filed Apr. 18, 2018).

The Zaslavskiy case is notable chiefly because the defendant moved to dismiss the indictment in part based on an argument that the cryptocurrency in that case was not a security, but rather a currency, and thus out of the purview of criminal or civil securities laws. In an order denying the defendant's motion to dismiss, the district court (the Eastern District of New York) disagreed, saying that while the question of whether Zaslavskiy "in fact offered a security, currency, or another financial instrument altogether, is best left to the finder of fact—unless the Court is able to answer it as a matter of law after the close of evidence at trial." The court held that while "Zaslavskiy's primary contention—that the investment scheme at issue did not constitute a security, as that term is defined under *Howey*, is undoubtedly a factual one," the indictment was sufficient to stand. "Simply labeling an investment opportunity as 'virtual currency' or 'cryptocurrency' does not transform an investment contract—a security—into a currency."

However, the question of whether any particular cryptocurrency is a security is not yet answered, and even in that case, the court stated that "the ultimate factfinder will be required to conduct an independent *Howey* analysis based on the evidence presented at trial."

SEC

The SEC first started litigating bitcoin issues in 2013, in the landmark SEC v. Shavers and Bitcoin Savings and Trust case, 2013 U.S. Dist. LEXIS 110018 (E.D. Tex. Aug. 6, 2013), in which the SEC accused Shavers of fraudulent offers and sales of a bitcoin-denominated security. The case ended in a final judgment enjoining Shavers and ordering disgorgement of over $40 million. Notably, the court in that case accepted that bitcoin was a security that fell under the SEC's regulatory authority.

In a November 2017 speech at the Institute of Securities Regulation, SEC Chairman Jay Clayton stated that the agency will crack down on coin offering issuers who fail to register with the agency or comply with federal laws. He added, “I have yet to see an ICO that doesn’t have a sufficient number of hallmarks of a security,” and expressed his concern with the “distinct lack of information about many online platforms that list and trade virtual coins or tokens offered and sold in initial coin offerings.”

Former SEC Commissioner Joseph Grundfest was less delicate in a New York Times article, calling ICOs “the most pervasive, open, and notorious violation of federal securities laws since the Code of Hammurabi.”

The SEC has put action behind these words, filing a series of litigations against coin or token issuers that were allegedly issued in violation of securities laws, including:

- SEC v. Haddow et al., 17-cv-4950 (S.D.N.Y., filed June 30, 2017)
- SEC v. ReCoin and DRC World Inc., 17-cv-5725 (E.D.N.Y., filed Sept. 29, 2017)
- SEC v. Plexcorps et al., 17-cv-7007, 2018 U.S. Dist. LEXIS 156308 (E.D.N.Y. Aug. 8, 2018), in which the court denied defendants’ motion to dismiss for lack of personal jurisdiction (note that the author serves as lead counsel in this matter)
- SEC v. AriseBank et al., 18-cv-186 (N.D.Tx., filed Jan. 25, 2018)
- SEC v. Montroll and BitFunder, 18-cv-1582 (S.D.N.Y., filed Feb. 21, 2018)
- SEC v. Sharma and Farkas, 18-cv-02909 (S.D.N.Y., filed April 2, 2018)
- SEC v. Titanium Blockchain Infrastructure Services et al., 18-cv-4315 (C.D.Ca., filed May 22, 2018)
- SEC v. Jesky et al., 18-cv-5980 (S.D.N.Y., filed July 2, 2018), which ended in a settlement where defendants agreed to disgorge approximately $1.4 million in gains and pay penalties, without admitting or denying liability

The SEC has also issued a series of summary trading suspensions against companies alleged to have issued cryptocurrency in violation of the registration requirements, including:

- Cherubim Interests, Inc.
- PDX Partners, Inc.
- Victura Construction Group, Inc.
- UBI Blockchain
- Munchee Inc.
- First Bitcoin Capital Corp.
- CIAO Group, Inc.
- Strategic Global Investments, Inc.
- Sunshine Capital, Inc.

Finally, the SEC has achieved some settlements outside of litigation, notably:

- In the matter of Tomahawk Exploration and David Thompson Laurence, 2018 SEC LEXIS 1988
- In the matter of Bitcoin Investment Trust and Secondmarket Inc., 2016 SEC LEXIS 3246

- In the matter of Erik Voorhees (FeedZeBirds and SatoshiDICE), Securities Act Release No. 9592 (June 3, 2014), available at: https://www.sec.gov/litigation/admin/2014/33-9592.pdf

The SEC recently obtained its first administrative settlement in a case alleging "broker-dealer" violations, notably of Section 8A of the Securities Act; Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940; and Section 9(f) of the Investment Company Act of 1940 (1940 Act), in In the Matter of Crypto Asset Management, LP and Timothy Enneking, 2018 SEC LEXIS 2241.

Some notable themes have emerged from these cases:

1. First, courts appear to have little difficulty issuing temporary restraining orders or preliminary injunctions against alleged offenders at the SEC's behest (see the preliminary injunction granted against defendants and relief defendant granted in *Haddow* and the preliminary injunction granted against defendant Stanley Ford in *AriseBank*).
2. Second, many defendants are challenging the notion that their particular cryptocurrency is a security, a battle being fought in private litigation as well. No cryptocurrency entities have yet successfully persuaded a court or factfinder that their cryptocurrency was not a security. There have been a handful of district court rulings on this topic, including in the Zaslavskiy case addressed in the DOJ section above, but no federal appellate decisions as of this writing.
3. Third, with its recent enforcement in a 1940 Act case, the SEC appears to be moving past the initial phase of cracking down on ICOs and moving into a broader arena. As the cryptocurrency markets grow in complexity and institutionalization, the SEC appears ready to oversee these markets as an offshoot or variant of traditional securities markets.

CFTC

The CFTC, for its part, has brought several federal litigations and administrative proceedings involving cryptocurrency derivatives. The agency's increased prosecutorial activity in the space triggers important compliance and registration consequences for market participants. For instance, cryptocurrency derivatives—such as options, futures, and/or swaps for which a unit of virtual currency is the underlying interest—will be treated as commodity interests under the Commodity Exchange Act (CEA) and CFTC rules.

This view was adopted earlier this year by Judge Jack B. Weinstein of the Eastern District of New York in CFTC v. McDonnell and CabbageTech, No. 18-cv-361 (JBW), 2018 U.S. Dist. LEXIS 36854 (E.D.N.Y., filed Mar. 6, 2018). In a detailed decision, Judge Weinstein held that the CFTC had standing to sue the defendants for violations of the CEA through the trading and purchasing of cryptocurrencies, such as bitcoin and Litecoin. He explained that virtual currencies fell within the catch-all portion of the CEA's definition of "commodity," which includes, inter alia, "all other goods and articles . . . and all services, rights and interests in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. § 1(a)(9). Citing the CFTC's recent complaint in CFTC v. Gelfman Blueprint and Nicholas Gelfman, No. 17-7181 (S.D.N.Y., filed Sept. 21, 2017), in which the CFTC summarily stated that bitcoin and other virtual currencies are encompassed in the definition of commodity under the CEA, the court reasoned that the CFTC had jurisdictional authority to bring an action against the defendants for violations of the CEA.

Following that decision, in August 2018, the court issued a memorandum with its findings of fact, conclusions of law, and directions for final judgment and injunction, in which it found that the defendants engaged in "fraudulent acts, including making material misrepresentations and omissions and misappropriating customer funds and virtual currencies," and were therefore liable for violations of Section 6(c)(1) of the CEA and Commission

Regulation 180.1(a). The court then permanently enjoined the defendants from engaging in conduct in violations of the CEA or CFTC regulations, as well as directly or indirectly trading in commodity interests, and further instituted civil monetary penalties to the tune of $290,429.29 plus post-judgment interest.

The CFTC also recently asserted jurisdiction and obtained a default judgment order in CFTC v. Dean and The Entrepreneurs Limited, No. 18-cv-345 (SJF)(AYS), (ECF. Doc No. 24) (Order and Default Judgment) (E.D.N.Y., filed July 9, 2018), against an individual and a corporate defendant that operated a bitcoin-funded commodity pool. In its January 18, 2018, complaint, the CFTC alleged that the defendants Dillon Michael Dean, a Colorado resident, and his company The Entrepreneurs Headquarters Limited, a UK-registered company, were engaged in a fraudulent scheme, whereby they solicited bitcoin from members of the public under the guise that the customers' funds would be pooled and invested in various financial derivative products, made Ponzi-style payments to commodity pool participants with other participants' funds, misappropriated pool participants' funds, and failed to register with the CFTC as a Commodity Pool Operator (CPO) and an Associated Person of a CPO (AP), as required under the CEA.

After the defendants failed to timely appear in the action, Judge Sandra J. Feuerstein of the Eastern District of New York issued an order of default judgment in favor of the CFTC, concluding that the defendants committed options fraud in violation of Section 4c(b) of the CEA, committed CPO fraud in violation of Section 4o(1), and failed to register as a CPO and as an AP in violation of Sections 4(m)(1) and 4(k)(2) of the CEA and Regulation 3.12(a). The order permanently enjoined the defendants from engaging in conduct in violations of such laws and regulations, as well as directly or indirectly trading in commodity interests.

But CFTC jurisdiction over cryptocurrencies as "commodities" under the CEA is not a foregone conclusion. In fact, earlier this year, certain individual defendants in CFTC v. My Big Coin Pay, Inc., No. 1:18-cv-10077-RWZ (D. Mass.) asserted in their motion to dismiss that:

> [P]er the plain language of the CEA, intangible "services, rights and interests" are only included in the CEA's definition of the term "commodity" if there are futures contracts traded on them. The only virtual currency on which futures contracts are traded is Bitcoin. So, because there are no futures contracts traded on My Big Coin, it is not a "commodity" as that term is defined in the CEA and the CFTC cannot make any showing that the Defendants violated the CEA.

The district court rejected this argument, at least at the motion to dismiss phase. In a September 26, 2018, decision (2018 U.S. Dist. LEXIS 164932 (D. Mass. Sep. 26, 2018)), the district court noted that although no futures contracts exist for My Big Coin, bitcoin futures are presently traded, and the CEA's definition of commodity should be read "generally and categorically." Thus, the court concluded, because futures trading exists in one virtual currency (Bitcoin), it was sufficient at the pleading stage for plaintiff to allege that another virtual currency (My Big Coin) is a commodity under the CEA. The *My Big Coin* court thus joined the *McDonnell* court in holding that a cryptocurrency could be a commodity—at least for the purposes of the agency surviving a motion to dismiss.

The CFTC has also instituted several administrative proceedings against various alleged offenders in the crypto space in the past few years. Most notably, in June 2016, the CFTC accepted an offer of settlement from Bitfinex in In the matter of BFNXA Inc., d/b/a Bitfinex, CFTC Docket No. 16-19 (Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, As Amended, Making Findings and Imposing Remedial Sanctions) (Filed June 2, 2016), 2016 CFTC LEXIS 22, in connection with Bitfinex's operation of an online platform for exchanging and trading cryptocurrencies, namely bitcoin. Without admitting or denying liability, Bitfinex consented to an order finding that engaged in illegal, off-exchange commodity transactions, and failed to

register as a futures commission merchant when it held purchased bitcoins in bitcoin deposit wallets that it owned and controlled, in violation of Sections 4(a) and 4d of the CEA.

Similarly, in September 2015, the CFTC accepted an offer of settlement from a Delaware corporation, Coinflip, and its founder, Francisco Riordan, after they operated a cryptocurrency derivatives platform that connected buyers and sellers of bitcoin options and futures contracts. Again, without admitting or denying liability, Coinflip and Riordan consented to an order finding that Coinflip violated of Sections 4c(b) and 5h(a)(1) of the CEA and Regulations 32.2 and 37.3(a)(1) by operating the platform without being registered as a swap execution facility or designated contract market under the CEA, CFTC Docket No. 15-29 (Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, As Amended, Making Findings and Imposing Remedial Sanctions) (Filed Sep. 17, 2015), 2015 CFTC LEXIS 20. The order also found that Riordan violated Section 13(b) of the Exchange Act, as a controlling person of Coinflip that did not act in good faith or knowingly induced, directly or indirectly, the Coinflip's violations of the CEA.

Other Federal Regulatory Litigation

Other federal agencies have been active as well, including FinCEN (e.g., U.S. v. BTC-E and Vinnick, 16-cr-227 (N.D.Ca., filed Jan. 17, 2017), in which FinCEN assessed a civil money penalty ($110 million as to BTC-e and $12 million as to Vinnik) as well as In re Ripple Labs, 2015 FINCEN LEXIS 12, also proceeding in the Northern District of California, alleging money laundering and Bank Secrecy Act violations).

The Federal Trade Commission has been active in the space as well, bringing a handful of unfair competition cases including:

- FTC v. Dluca (d/b/a Bitcoin Funding Team and My7Network), 2018 U.S. Dist. LEXIS 49530 (S.D.Fla. Mar. 22, 2018)
- FTC v. Equiliv Investments and Ryan Ramminger, 14-cv-00815 (D.N.J., filled June 29, 2015) (resulting in a stipulated order for permanent injunction and monetary judgment)
- FTC v. BF Labs, Inc., d/b/a Butterfly Labs, 14-cv-00815 (W.D. Mo., filed Sept. 14, 2014) (resulting in a stipulated order for permanent injunction and monetary judgment)

Finally, the IRS maintains an active watch over cryptocurrency markets, including by filing a petition to enforce a summons for information on users of a cryptocurrency exchange, see U.S. v. Coinbase, 2017 U.S. Dist. LEXIS 196306 (N.D. Cal. Nov. 28, 2017) (which petition was granted in part).

Regulatory Enforcement by the States

On May 21, 2018, the North American Securities Administrators Association (NASAA), a group of U.S. state and Canadian provincial regulators, announced Operation Cryptosweep, which to date "has resulted in nearly 70 inquiries and investigations and 35 pending or completed enforcement actions related to ICOs or cryptocurrencies since the beginning of May."

Through September 2018, there have been a slew of summary cease and desist orders or other regulatory actions from state securities administrators. Some states began cracking down even before the NASAA effort, including the Texas State Securities Board, which has been vocal about what it sees as "Widespread Fraud Found In Cryptocurrency Offerings," and Massachusetts, which has also been active in regulatory enforcement in the space.

The following is a (partial) list of cease and desist orders and administrative proceedings from the various states, and the state regulations on which they are based (mostly echoing federal anti-fraud provisions and securities registration requirements):

COLORADO

In the Matter of Linda Healthcare Corporation Co. and Arturo Devesa, 2018 Colo. Sec. LEXIS 16	5/2/2018	C.R.S. § 11-51-201, 301
In the Matter of Broad Investments, LLC and Guoyong Liu	5/2/2018	C.R.S. § 11-51-201, 301

MARYLAND

In the Matter of Browsers Lab, LLC	5/21/2018	M.S.A. §§ 11-501, 11-401, 11-402, 11-301

MASSACHUSETTS

In the Matter of Sparkco, Inc. d/b/a Librium, 2018 Mass. Sec. LEXIS 11	3/27/2018	Mass. Gen. Laws ch. 110A § 301
In the Matter of Pink Ribbon ICO, 2018 Mass. Sec. LEXIS 10	3/27/2018	Mass. Gen. Laws ch. 110A § 301
In the Matter of Mattervest, Inc., 2018 Mass. Sec. LEXIS 9	3/27/2018	Mass. Gen. Laws ch. 110A § 301
In the Matter of Across Platforms, Inc. d/b/a ClickableTV, 2018 Mass. Sec. LEXIS 8	3/27/2018	Mass. Gen. Laws ch. 110A § 301
In the Matter of 18Moons, Inc., 2018 Mass. Sec. LEXIS 7	3/27/2018	Mass. Gen. Laws ch. 110A § 301
In the Matter of Caviar and Kirill Bensonoff	1/17/2018	Mass. Gen. Laws ch. 110A § 201, § 301; Massachusetts Uniform Securities Act; 950 Mass. Code Regs 10.00–14.413

NEW JERSEY

In the Matter of Springcryptoinvest, 2018 N.J. Sec. LEXIS 11	5/21/2018	N.J.S.A. 49:3-56 and 49:3-52(b)
In the Matter of Bullcoin Foundation a/k/a Bullcoin Gold, 2018 N.J. Sec. LEXIS 9	5/21/2018	N.J.S.A. 49:3-56 and 49:3-52(b)
In the Matter of Trident a/k/a Trident Crypto Index Fund, 2018 N.J. Sec. LEXIS 12	5/21/2018	N.J.S.A. 49:3-56 and 49:3-52(b)

In the Matter of Bitcoiin a/k/a Bitcoiin B2G, 2018 N.J. Sec. LEXIS 3	3/7/2018	N.J.S.A. 49:3

NORTH CAROLINA

In the Matter of Adosia LLC and Kyle Solomon, 2018 N. Car. Sec. LEXIS 13	5/10/2018	N.C. Gen. Stat. §§ 78A-24; 78A-36
In the Matter of Power Mining Pool	5/2/2018	N.C. Gen. Stat. §§ 78A-24; 78A-36

SOUTH CAROLINA

In the Matter of ShipChain, Inc. (d/b/a ShipChain.io), 2018 S. Car. Sec. LEXIS 14	5/21/2018 C&D vacated 7/26/2018	S.C. Code Ann. §§ 35-1-301, 35-1-401(a), 35-1-401(d)
In the Matter of Swiss Gold Global, Inc. and Genesis Mining, Ltd., 2018 S. Car. Sec. LEXIS 6	3/9/2018	S.C. Code Ann. § 35-1-101 et seq.

TEXAS

In the Matter of Wind Wide Coin a/k/a WWC, Inc., 2018 Tex. Sec. LEXIS 12	5/15/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12
In the Matter of Forex EA & Bitcoin Investment LLC a/k/a My Forex EA & Bitcoin Investment LLC a/k/a Forex EA, 2018 Tex. Sec. LEXIS 11	5/8/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12
In the Matter of Bitcoin Trading & Cloud Mining Limited a/k/a BTCRUSH, 2018 Tex. Sec. LEXIS 10	5/8/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12
In the Matter of LeadInvest, 2018 Tex. Sec. LEXIS 7	2/26/2018	Texas Securities Act § 23-2
In the Matter of Investors of Crypto LLC and Daniel Neves, 2018 Tex. Sec. LEXIS 8	2/26/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12
In the Matter of DavorCoin, 2018 Tex. Sec. LEXIS 4	2/26/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12
In the Matter of R2B Coin, 2018 Tex. Sec. LEXIS 3	1/24/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12

Texas State Securities Board v. Bitconnect	1/4/2018	Texas Securities Act § 23-2; Texas Securities Act §§ 7, 12
Texas State Securities Board v. Balanced Energy LLC and Kirk Johnson, 2014 Tex. Sec. LEXIS 4	3/10/2014	Texas Securities Act § 23-2

VERMONT

In the Matter of LevelNet Inc.	5/28/2018	9 V.S.A. §§ 5301, 5401(a), 5402(a); V.S.R § 3-1(e)(16)

These state actions potentially raise jurisdictional concerns. Where the state regulator is issuing a summary cease and desist order, is there due process sufficient to show minimum contacts with the forum? See Personal Jurisdiction (Federal) and Motion to Dismiss for Lack of Personal Jurisdiction: Making the Motion (Federal). Particularly where an offering is being conducted from abroad, and is not operating within the state in question, how can a state securities regulator decide to summarily close an entire foreign business operation on the assertion that the operation violated the securities law of a particular state?

Particularly after the Supreme Court's decision in Daimler AG v. Bauman, 571 U.S. 117 (2014), eviscerated the notion of general corporate jurisdiction outside that corporation's "nerve center," there needs to be a showing that the company or individual is doing business specifically in that state, sufficient to trigger the state's long-arm jurisdiction statutes, and in a way that does not offend constitutional due process. And after the Supreme Court's decision in Morrison v. National Australia Bank, 561 U.S. 247 (2010), it is unclear whether states have the right to apply their laws to extraterritorial securities trading in the first place, to the extent foreign cryptocurrency transactions are "extraterritorial"—another point that has not yet been decided by the courts.

In the absence of solid federal guidance on cryptocurrency regulation, different states are regulating in different ways. Wyoming's movement toward blockchain-friendly laws, Arizona's "sandbox" initiative, and Delaware's consideration of corporate-records blockchains may not square with the stricter views taken by Texas and Massachusetts. It remains to be seen whether the states will diverge in their regulatory approaches, or whether a federal approach drive by the SEC will help unify the states and return securities regulation to a more national issue.

Private Litigation

Cryptocurrency issues have triggered a host of private litigation as well. Some of the litigation is essentially traditional securities or other corporate litigation, in a cryptocurrency setting. See Liability under the Federal Securities Laws for Securities Offerings and Shareholder Derivative Litigation.

For example, a series of cases (either direct or putative class action cases) allege misrepresentations or omissions in the sale of cryptocurrency as if it were a traditional security stock drop case, often adding a claim under Section 5 (15 U.S.C. § 77e) of the Securities Act that the cryptocurrency was not properly registered in the first place. Such cases include:

- Balestra v. Cloud With Me LTD., Gilad Somjen, and Asaf Zamir, 05-mc-02025 (W.D. Pa., filed June 19, 2018)
- Coffey v. Ripple Labs et al., 18-cv-03286 (removed to N.D. Cal.), 2018 U.S. Dist. LEXIS 135585 (N.D. Cal.

Aug. 10, 2018)

- Brola v. Nano et al., 18-cv-2049 (E.D.N.Y., filed April 6, 2018)
- Miller v. Longfin Corp. et al., 18-cv-3121 (S.D.N.Y., filed April 9, 2018)
- Chen Wei v. Longfin Corp., et al, 18-cv-3462 (S.D.N.Y., filed April 19, 2018)
- Moss v. Giga Watt, 18-cv-100 (E.D.Wa., filed March 19, 2018)
- Davy v. Paragon Coin, Inc., 18-cv-671 (N.D. Cal., filed Jan. 30, 2018)
- Kline v. Bitconnect et al., 18-cv-319 (M.D. Fla., filed Feb. 7, 2018) transferred to 18-cv-80512 (S.D.Fla., filed April 17, 2018)
- Paige v. Bitconnect et al., 18-cv-58 (W.D. Ky., filed Jan. 29, 2018)
- Wildes et al. v. Bitconnect Int'l PLC et al., 18-cv-80086 (S.D. Fla., filed Jan. 24, 2018)
- Peng Li Secretary of the Interior v. Xunlei Limited; Lei Chen; Eric Zhou; Tao Thomas Wu, 18-cv-646, 2018 U.S. Dist. LEXIS 62575 (S.D.N.Y., filed Apr. 12, 2018)
- Dookeran v. Xunlei Ltd., 18-cv-467, 2018 U.S. Dist. LEXIS 62575 (S.D.N.Y., filed Apr. 12, 2018)
- Stormsmedia, LLC v. GigaWatt, Inc., 2018 U.S. Dist. LEXIS 9394(E.D. Wash., filed Jan. 19, 2018) (case dismissed)
- Balestra v. ATBCoin LLC, 17-cv-10001 (S.D.N.Y., filed Dec. 21, 2017)
- Hodges v. Monkey Capital, 17-cv-81370 (S.D. Fla., filed Dec. 19, 2017) (final default judgment granted)
- GGCC v. Dynamic Ledger Solutions et al. (Tezos), 17-cv-6779 (N.D. Cal., filed Nov. 26, 2017)
- Gaviria v. Dynamic Ledger Solutions et al. (Tezos), 17-cv-1959 (M.D. Fla., filed Nov. 13, 2017) (case dismissed without prejudice following plaintiff's notice of voluntary dismissal)
- Shepherdson v. The Crypto Company, 17-cv-9157 (C.D. Cal., filed Dec. 21, 2018) (case dismissed)
- Oksuko v. Dynamic Ledger Solutions et al. (Tezos), 17-cv-6829 (N.D. Cal., filed Nov. 28, 2017)

These cases are likely to play out in similar ways to traditional securities class action cases in many ways, assuming plaintiffs can establish that the cryptocurrency at issue is a security in the first place. Plaintiffs were able to do so in Rensel v. Centra Tech, Inc., 2018 U.S. Dist. LEXIS 106642 (S.D.Fla., June 25, 2018), in an order granting plaintiff's renewed motion for a temporary restraining order and finding that the token at issue was a security under the Howey test.

Echoing the movements in the securities class action world, some price drop suits have been brought in state courts, alleging mostly (or exclusively) state law claims, or Securities Act claims that might survive in state court. Coffey v. Ripple Labs was removed to federal court (in the Northern District of California), which court denied plaintiff's motion to remand, 2018 U.S. Dist. LEXIS 135585 (N.D. Cal. Aug. 10, 2018).

Other similar cases originally filed in state court include:

- Joseph Bents, derivatively on behalf of Longfin Corp. v. Venkat S Meenavalli; Vivek K Ratakonda; Ghanshyam Dass; Yogesh Patel; Linda M Gaddi; David Nichols; John Parker; Henry Wang; Longfin Corp., 653216/2018 (Supreme Court of New York, County of New York, filed June 26, 2018) (alleging breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, waste of corporate assets)

- John Hastings, individually and on behalf of others similarly situated v. Unikrn, Inc., a Delaware Corporation; Unikrn Bermuda, Ltd, a Bermuda corporation; Rahul Sood, an individual, Karl Flores, an individual, and DOES 1-25, 18-2-20306-6 (Superior Court of Washington for King County, filed Aug. 13, 2018)

Other cases involve more traditional corporate issues with a cryptocurrency twist, including:

- **IP rights.** Alibaba Group Holding Ltd. v. Alibabacoin Foundation et al., 18-cv-2897 (S.D.N.Y., filed April 2, 2018) and Founder Starcoin, Inc. v. Launch Labs Inc. (d/b/a Axiom Zen), 08-cv-972 (S.D.Ca., filed May 16, 2018).
- **contract rights, including possession of the cryptocurrency at issue.** Shaw v. Vircurex et al., 18-cv-67 (D.Co., filed Jan. 10, 2018) (default judgment entered against defendants) and R3 HoldCo LLC v. Ripple Labs, Inc., 2017-0652 (Delaware Chancery court, filed Sept. 8, 2017) (dismissed for lack of personal jurisdiction over an indispensable party).

Finally, one case, Kleiman v. Wright, 18-cv-80176 (S.D.Fl., filed Feb. 14, 2018), purports to be about the very invention of bitcoin, and even apart from its legal intricacies, its resolution may well shed light on the mystery of Satoshi Nakamoto and bitcoin's invention.

LEGAL ISSUES YET TO BE RESOLVED

Given that the cryptocurrency field is relatively new, many legal issues remain unresolved.

First, is cryptocurrency a security? A commodity? A currency? Something else? Does it matter how it is used? Is it, as Mr. Clayton has seemed to suggest, a case-by-case test?

Second, where are the bounds of each regulator's authority? How will the different states pull against each other, or against the federal agencies? Will there be a "concurrent jurisdiction" as there is for securities regulation, occasionally leading to overlapping investigations and settlements? While there is a federal task force organized by the Treasury Department involving a host of different federal agencies, will the different federal regulators agree on each other's respective turfs? Or will there be gaps between them?

Third, what is the best path for a company to raise funds through a cryptocurrency sale? Structuring an ICO under the Regulation CF (Title III of the JOBS Act - Crowdfunding), Regulation A-Plus (Title IV of the JOBS Act), or even as an initial public offering (IPO) are all theoretically legitimate alternatives to operating an unregistered offering. Regulation CF allows private companies that issue through a registered intermediary crowdfunding platform to raise up to $1 million from any type of investor. Regulation A+ permits issuers that obtain SEC preclearance and qualification to launch a mini-IPO, raising as much as $50 million from accredited and non-accredited investors alike. Regulation A+ issuers may also "test the waters," soliciting investor interest before spending the time and money to seek qualification of the offering. Additional options include offerings under Rule 506 of Regulation D or Regulation S, which may bring other limitations, such as Regulation D's limitations requiring accredited investors (depending on whether the offering is under Rule 506(b) or Rule 506(c)), or Regulation S's limitations to offerings made entirely outside the United States. But the SEC has yet to approve (as of this writing) any Regulation A+ cryptocurrency offerings, and Regulation D brings its own limitations. See Crowdfunding Regulations, JOBS Act Crowdfunding Regulations, Crowdfunding Intermediaries under the JOBS Act, Regulation A Plus, and Initial Public Offering Process.

INTERNATIONAL CHALLENGES

Another significant issue is how cryptocurrency law and litigation will play out across borders. Cryptocurrency is, by its nature, not bound by national borders. The nature of blockchain applications means that a transaction is recorded everywhere on that blockchain at once. That could literally be anywhere in the world. This dynamic yields problems for regulators that are bound by national laws and regulations. It also creates problems for international cryptocurrency businesses, which may not be sure of the full slate of regulations in every country they might do business—which, given the nature of cryptocurrency, could be any or all of them. See Foreign Private Issuer Resource Kit, Securities Finance in International Jurisdictions, and Securities Litigation in International Jurisdictions.

Different countries may regulate differently, but the nature of the transaction is essentially the same globally. Should cryptocurrency issuers or traders follow local law? Or should they follow of the laws of the "most stringent" jurisdiction? Or should they try to take advantage of the "least stringent" jurisdiction by working (physically or virtually) from there?

In practice, how well do "country exclusion lists" work? Can an ICO issuance "bubble off" certain countries—that is, completely exclude them from participating in the securities raise by strictly limiting advertisements, solicitation, and purchases, given the nature of cryptocurrency? What happens in secondary offerings, or trading beyond the initial issuance? How is the picture changed when an essentially non-U.S. cryptocurrency begins to trade on a U.S. market or exchange?

Regulation in the U.S. of Extraterritorial Cryptocurrency Transactions

In the United States, Morrison v. National Australia Bank, 561 U.S. 247 (2010) limits the extraterritorial application of the federal securities laws: "When a statute gives no clear indication of an extraterritorial application, it has none." It reflects the "presumption that United States law governs domestically but does not rule the world." Microsoft Corp. v. AT&T Corp., 550 U.S. 437, 454 (2007). Further, *Morrison* emphasizes that "possible interpretations of statutory language do not override the presumption against extraterritoriality."

In some cases, the SEC has asserted that *Morrison* does not apply to litigation brought by the SEC, on the theory that Section 929P of the Dodd-Frank Act (signed into law on July 21, 2010) partially overruled the *Morrison* decision (issued June 24, 2010), and revived the pre-*Morrison* "conducts and effects" test for the SEC. A single district court has accepted that argument as forwarded by the SEC. See SEC v. Traffic Monsoon, LLC, 245 F. Supp. 3d 1275 (D. Utah 2017). The district court's holding in *Traffic Monsoon* was certified for an immediate interlocutory appeal, and (as of October 2018) is currently awaiting decision by the Tenth Circuit. No other court has yet reached such a finding, though others have noted the argument or discussed it in dicta. For example, see SEC v. Fujinaga, 2014 U.S. Dist. LEXIS 141801 (D. Nev. 2014); SEC v. Chicago Convention Ctr., LLC, 961 F. Supp. 2d 905 (N.D. Ill. 2013); SEC v. Gruss, 859 F. Supp.2d 653 (S.D.N.Y. 2012); SEC v. Compania Internacional Financiera, 2011 U.S. Dist. LEXIS 83424 (S.D.N.Y. 2011).

Several commentators have stated that it is highly doubtful Section 929P was actually intended to overrule *Morrison* in that way. For example:

- "While the Congress's intent in passing the Dodd-Frank Act seems directed at empowering the SEC and DOJ to combat securities fraud, one can credibly argue that they failed to do so." Richard Painter, et al., "When Courts and Congress Don't Say What They Mean: Initial Reactions to Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act," 20 Minn. J. Int'l L. 1, 4 (Winter 2011).
- "[T]he ability of these agencies to enforce the anti-fraud provisions of the U.S. securities laws is no clearer

than it was prior to the Dodd-Frank Act's enactment. Consequently, despite the drafters' intentions to the contrary, the presumption against extraterritorial application of the provision is not overcome by the Act's provisions." Andrew Rocks, "Notes: Whoops! The Imminent Reconciliation of U.S. Securities Laws with International Comity After Morrison v. National Australia Bank and the Drafting Error in the Dodd-Frank Act," 56 Vill. L.Rev. 163, 192 (2011).

Other commentators describe the statutory language in similarly critical terms, calling it:

- A "drafting error" in Joshua L. Boehm, "Private Securities Fraud Litigation After Morrison v. National Australia Bank: Reconsidering A Reliance-Based Approach to Extraterritoriality," 53 Harv. Int'l L.J. 249, 261 (2012)
- "Less than meticulous" in Beyea, supra at 573 –and–
- A "drafting error" in Rocks, supra at 187

The reason for this criticism is that Section 929P(b) explicitly addresses jurisdictional issues, and not the scope of the reach of the federal securities laws. There is little doubt that district courts have the jurisdiction to hear cases involving conduct within the United States. But it is unclear whether Section 929P contravened the Supreme Court's mandate in *Morrison* that the substantive reach of the federal securities laws extends only to domestic transactions.

Section 929P would not apply to private litigation, and defendants have begun to make the argument. For example, defendants moved to dismiss in GGCC v. Dynamic Ledger Solutions et al., 17-cv-6779 (N.D. Cal., filed Nov. 26, 2017), in part on Morrison grounds. The district court denied the motion to dismiss, because the "realities of the transaction (at least as alleged . . .)" suggested that irrevocable liability took place in the United States.

Despite this holding, *Morrison* is likely to be a cause for dismissal of cryptocurrency suits in the future and may well forestall truly foreign suits from being filed in the first place.

ADDITIONAL ANGLES FOR FUTURE LITIGATION AND ENFORCEMENT

Exchanges

Exchanges face scrutiny from both the SEC (which includes its regulatory oversight of exchanges literally in its name), as well as private plaintiffs. Traditional SEC-approved exchanges enjoy some limited immunity (see 15 U.S.C. § 78s(d)(2), though an immunity but see, e.g., City of Providence v. BATS Global Markets, Inc., No. 15-3057 (2d Cir. 2017) (addressing limitations of exchange liability in some circumstances). However, as no cryptocurrency exchange is (as of October 2018) yet approved, it is difficult to imagine such immunities would exist. As a consequence, exchanges are susceptible to private lawsuits, and indeed, at least two such lawsuits have been filed, claiming wrongs by the exchange Coinbase: Faasse v. Coinbase, Inc., 18-cv-1382 (N.D.Ca., filed March 2, 2018), and Berk v. Coinbase, Inc., 18-cv-1364 (N.D.Ca., filed March 1, 2018).

A comprehensive set of rules for cryptocurrency exchanges that provides some immunities similar to traditional exchanges and alternative trading systems (ATSs) may be promulgated in the future, but until that time, the exchanges will bear extra litigation risk.

Futures and Derivatives

The SEC and CFTC are grappling with whether to allow any cryptocurrency futures or derivatives to trade at all. While the CFTC has allowed bitcoin futures to trade, Mr. Giancarlo emphasized in his testimony to the Senate Banking Committee that bitcoin futures are quite different from bitcoin itself, as they are fully transparent to the

regulator and traded on regulated exchanges. Further, he said, by allowing bitcoin futures, the CFTC gained data on underlying spot markets that it would not otherwise have had. See Financial Derivatives.

The SEC, for its part, has denied a series of applications for bitcoin exchange-traded funds (ETFs) and similar variants, including the Winklevoss Bitcoin Trust (proposed by the Winklevoss brothers, of Facebook development fame); the ProShares Bitcoin ETF and the ProShares Short Bitcoin ETF; the GraniteShares Bitcoin ETF and the GraniteShares Short Bitcoin ETF; the Direxion Daily Bitcoin Bear Shares; and others. See Exchange-Traded Funds (ETFs).

It remains to be seen whether cryptocurrency futures or derivatives will take on a more significant role in trading markets.

Insider Trading

The increase in regulatory attention will likely also spark regulators to eye cryptocurrency and cryptocurrency derivative products for insider trading abuses.

The United States does not have one single “insider trading” statute that defines and bans insider trading. Instead, federal law addresses insider trading through judicial interpretations of the statutory prohibitions on fraud in connection with the purchase or sale of securities, commodity futures, options, or swaps, and in certain instances in connection with a tender offer or for short-swing profits earned by certain defined insiders (whether from the misuse of insider information or not). See Insider Trading Claims: Defenses.

In general, the rules prohibit trading or the receipt of benefits based on material nonpublic information in violation of a duty of confidence. Under so-called “classic liability,” the insider learns material nonpublic information and trades on the basis of that information. “Tipper liability,” in contrast, can arise when one has a duty to keep certain material nonpublic information confidential but communicates that information to someone else when it is reasonably likely they will trade on the information and receives a personal benefit for providing such information. Similarly, “tippee liability” can arise when one trades on material nonpublic information obtained from someone whom they are aware has a duty to keep that information confidential.

While no such cases in the cryptocurrency realm have yet been brought by the SEC, it seems a matter of time before an insider at a cryptocurrency company with a fiduciary duty to keep information confidential trades for his or her own account, potentially triggering insider trading liability.

Pump-and-Dump Schemes

One age-old scheme in the securities trading world is the “pump-and-dump,” in which a group of stock owners create artificial excitement in a security in order to boost its price on non-fundamental reasons, and then sell their shares after appreciation. News stories about similar schemes in the cryptocurrency have been circulating, and the SEC has taken an interest in shutting down such schemes. These schemes are a virtual synecdoche for the larger panoply of traditional stock frauds—Ponzi schemes and the like—that are certain to develop in the cryptocurrency world just as they exist in the traditional securities world. Similar to insider trading, while no such case has been brought as of this writing, it seems a matter of time before the age-old market manipulation strategies are cross-applied to the cryptocurrency world as well —followed by the same type of enforcement and private litigation.

CONCLUSION

To say that the state of cryptocurrency regulation is “rapidly developing” is an understatement. Major judicial opinions signaling potential sea changes in the law have continued to come down during the preparation and updating of this note. Those changes will continue, as the SEC, CFTC, and other regulators grapple with the notion of how cryptocurrencies can be integrated into the financial system. For now, practitioners must proceed with an abundance of caution, and stay abreast of the latest developments in cryptocurrency regulation and litigation.

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