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# Jurisdictional Overreach by Regulators in Cryptocurrency Actions

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Tremendous uncertainty currently surrounds cryptocurrency regulation. The SEC and the CFTC both claim jurisdictional authority – sometimes over the same products – yet no new legislation has been passed, no new regulations have been promulgated, and very few court decisions have addressed the issue of who, if anyone, has regulatory authority over cryptocurrency.

A slew of regulatory enforcement cases currently pending in the courts may settle the issue one way or the other. Or, they could result in a patchwork of case law that leads to years of appeals, conflicting decisions, and further uncertainty. Faced with this lack of clarity, courts handling these actions should be mindful of the statutory scope of the relevant regulatory agencies' authority.

There have been few court decisions squarely addressing the question of whether cryptocurrency is regulated by the SEC, CFTC, some other agency, or no agencies at all. Nevertheless, recent litigation concerning actions brought by the SEC and CFTC are instructive. In August 2013, an Eastern District of Texas court held in *SEC v. Shavers* that investments in an entity that would provide returns in the form of Bitcoins were securities.[1] The court also determined that Bitcoin was a form a currency, thereby subject to the Bank Secrecy Act.[2]

The court reasoned: "Bitcoin can be used as money," and that its "only limitation … is that it is limited to those places that accept it as currency … [t]herefore, Bitcoin is a currency or form of money, and investors wishing to invest in [the entity] provided an investment of money."[3] The Court then concluded that, since the investments in the entity met the other three prongs of the *Howey* test,[4] the SEC had standing to bring an action against Shavers for violations of Sections 20 and 22 of the Securities Act of 1933 and Sections 21 and 27 of the Exchange Act of 1934.

More recently, an Eastern District of New York court held in *CFTC v. McDonnell*[5] that the CFTC had standing to sue the defendants for violations of the Commodity Exchange Act ("CEA") through the trading and purchasing of cryptocurrencies, such as Bitcoin and Litecoin. In a lengthy decision, Judge Jack Weinstein wrote 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."[6] Citing the CFTC's recent complaint in *CFTC v. Gelfman Blueprint, Inc*,.[7] 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[8]

Certainly, the CFTC agrees with this result, which is consistent with its public pronouncements. In written testimony to the Senate Banking Committee on February 6, 2018, CFTC Chair Christopher Giancarlo conceded that "the CFTC does NOT have regulatory jurisdiction under the CEA over markets or platforms conducting cash or 'spot' transactions in virtual currencies or other commodities or over participants on such platforms." However, he continued, "the CFTC DOES have enforcement jurisdiction … against fraud and manipulation in virtual currency derivatives markets and in underlying virtual currency spot markets."[9] (All emphasis in original.)

But the holding of the *McDonnell* court – as well as the views of Chair Giancarlo – emphasize the inconsistences facing issuers, investors, and practitioners. For instance, the CFTC's regulatory authority derives from the CEA, under which it has promulgated regulations prohibiting, *inter alia*, manipulation "in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity."[10] The word "commodity" is a term of art, defined in 17 C.F.R. § 1.3 to mean various enumerated goods "and all other goods and articles" (with certain limited exceptions) "in which contracts for future delivery are presently or in the future dealt in."

This limitation on the definition of commodity – to only those in which contracts for future delivery are dealt – is critical; without it, all "goods and articles" would be commodities, and the CFTC would have jurisdiction over an unimaginable array of transactions in our everyday lives: the purchase of an apple at the corner bodega, a mountain bike, a new cell phone, a shirt, and literally everything else. Your corner bodega owner would be shocked to learn that his advertisement of "fresh fruit" could trigger a lawsuit from the CFTC if the apples were spoiled.

Far from being a mere technicality, targets of regulatory enforcement in the cryptocurrency space are already deploying jurisdictional arguments as defenses. For instance, the defendants in *CFTC v. My Big Coin Pay, Inc. et al.*[11] recently asserted:

> [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.[12]

Although Chairman Giancarlo has jokingly referred to My Big Coin as "My Big Con,"[13] the jurisdictional issues at stake are serious, and *My Big Coin* has the potential to stand as a powerful counterweight to *McDonnell*.

The protection of investors in the exploding cryptocurrency markets, and the burgeoning markets for crypto-futures and crypto-derivatives, is a paramount concern. And in the face of the uncertainty surrounding the scope of the regulators' authority, and with allegations of fraud in cryptocurrency markets filling the business sections, courts may be tempted to put their

collective thumbs on the scale for the regulators by granting them, through judicial interpretation, authority beyond the black-letter law.

Nevertheless, courts should resist the temptation to expand regulators' authority past their legal limits. Federal agencies such as the SEC and the CFTC have a responsibility to monitor and regulate those portions of the markets within their authority – but only within the scope of their authority. To the extent products fall outside existing regulations, the agencies should request new legislation, which should be passed through a democratically-elected Congress, rather than attempting to expand their Congressional authority through case law. It is vital that the SEC and CFTC regulate their respective jurisdictional markets, but it is equally vital that they are constrained to regulate only what elected lawmakers have decided is within their jurisdiction.

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1 *SEC v. Shavers et al*, No. 4:13-cv-416, 2013 U.S. Dist. LEXIS 110018, at *6 (E.D. Tex. Aug. 6, 2013).

2 *Id.* at *4-5.

3 *Id.*

4 *Id.* at *5-6.

5 *CFTC v. McDonnell*, No. 18-cv-361, 2018 U.S. Dist. LEXIS 36854 (E.D.N.Y. Mar. 6, 2018).

6 7 U.S.C. § 1(a)(9)).

7 No. 17-7181 (S.D.N.Y. (Filed Sept. 21, 2017). It is worth noting that the *Gelfman* complaint provides no legal support for this statement beyond a citation to the statute itself. *Gelfman*, Complaint, (Doc. No. 1) at *4.

8 *McDonnell*, No. 18-cv-361, 2018 U.S. Dist. LEXIS 36854, at *103 (citing 7 U.S.C. § 9(1)).

9 https://www.banking.senate.gov/imo/media/doc/Giancarlo%20Testimony%202-6-18b.pdf

10 17 C.F.R. § 180.1. This regulation was a creation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Prior to *Gelfman*, the CFTC had never employed it in connection with a virtual currency action.

11 *CFTC v. My Big Coin Pay Inc. et al.*, No. 1:18-cv-10077-RWZ (D. Mass., April 3, 2018).

12 Defendants' Opposition to Plaintiff's Motion For Preliminary Injunction, *My Big Coin Pay, Inc.* (Doc. No. 49) at * 8-9.

13 https://www.banking.senate.gov/hearings/virtual-currencies-the-oversight-role-of-the-us-securities-and-exchange-commission-and-the-us-commodity-futures-trading-commission