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# POLICING THE

# ★ WILD WEST ★ OF CRYPTOCURRENCY

## PART II

**The ability of federal and state regulators to work together will determine whether the Wild West of cryptocurrency enforcement will be won**

**ARE** Are cryptocurrencies a dangerous bubble set to explode or the future of financial technology? Should they be regulated and enforced as property, a security, a commodity, or a virtual convertible currency? Presiding at the Berkshire Hathaway 2018 annual shareholder meeting, famed investor and CEO Warren Buffet described the cryptocurrency Bitcoin as “probably rat poison squared.”<sup>1</sup> Charles Munger, Berkshire’s vice-chairman, added that cryptocurrencies are “just dementia.”<sup>2</sup> Darren Marble, CEO of CrowdfundX, countered: “Years from now, when the dust settles, Warren Buffett’s miss on Bitcoin will be the biggest miss of his career.... How could someone who doesn’t use email possibly appreciate Bitcoin? They can’t.”<sup>3</sup>

With cryptocurrency prices soaring and falling tremendously since 2017 and new virtual currencies, blockchain-based companies, and Initial Coin Offerings (ICOs) coming out on a weekly basis, how will the “crypto-sheriffs” police this new financial Wild West? In addition to the Internal Revenue Service (IRS), the Securities and Exchange Commission (SEC), the Commodities Futures Trading

Commission (CFTC), the Department of Treasury’s Financial Crimes Enforcement Network (FinCEN), and state regulators have each claimed authority to regulate and enforce a part of the “crypto-frontier,” at times creating overlapping jurisdiction. Their ability to work together in this fluid environment and to create new rules, regulations, and law enforcement techniques to address the unique aspects of virtual currency will determine whether the Wild West of cryptocurrency enforcement will be won.

**H**ow has the SEC’s mission to “protect investors, maintain fair, orderly and efficient markets and facilitate capital formation” intersected with the cryptocurrency world?<sup>4</sup> On the one hand, the cryptocurrency world thus far has been a miniscule but growing blip on the SEC’s radar. For instance, there was approximately \$4 billion raised in ICOs in 2017 (many ICOs are similar to initial public offerings and operate as a means for blockchain-based businesses to raise funds for new projects by selling digital tokens that confer some value or right to the users).<sup>5</sup> In contrast with this \$4 billion raise, there were approx-

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imately \$75 trillion in securities traded annually on U.S. equity markets involving 4,100 exchange-listed public companies with a market capitalization of \$31 trillion.<sup>6</sup> Thus, though growing exponentially, the cryptocurrency market comparatively constitutes well less than one percent of the overall financial market.

On the other hand, the SEC realizes it needs to proactively get in front of regulating and enforcing laws dealing with cryptocurrencies before the investor public gets overrun with fraudulent, deceptive, and illegal activity. Thus, over the last number of years, the SEC has taken an expansive role of its jurisdiction, viewing the issuance of virtual currencies as “securities” in most instances. In 2013, former SEC Chair Mary Jo White stated: “Regardless of whether an underlying virtual currency is itself a security, interests issued by entities owning virtual securities or providing returns based on assets such as virtual currencies likely would be securities and therefore subject to our regulation.”<sup>7</sup> The SEC concluded that cryptocurrencies constitute “securities,” regardless of how they are labelled, if they fall within the “investment contract” category of securities.

Over 70 years ago, the U.S. Supreme Court in *SEC v. W. J. Howey Company*<sup>8</sup> defined an “investment contract” as a contract, transaction, or scheme in which 1) a person invests money in a common enterprise, 2) with a reasonable expectation of profits, 3) to be derived solely from the entrepreneurial or managerial efforts of others. The “*Howey* test” was designed to be “flexible” and “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>9</sup> Simply calling cryptocurrency a “currency” or a “utility token” does not make it a security since the economic realities and substance of transaction, not its form, will control.<sup>10</sup> Under this test, Jay Clayton, the current SEC chair, has publicly stated in numerous settings that all the cryptocurrency offerings he has seen are securities, none of which have been registered and all of which have been traded on unlicensed and unapproved trading platforms. Since July 2017, warnings by the SEC and Chair Clayton to the public have included:

- In July 2017, the SEC issued investor bulletin warnings about ICOs<sup>11</sup> and a Report of Investigation under Section 21(a) of the Securities Exchange Act of 1934 describing an SEC investigation of a decentralized autonomous organization (DAO) and its use of distributed ledger or blockchain technology to sell DAO Tokens, a virtual currency, to raise capital; the SEC determined that DAO Tokens were securities and those who sold them had to comply with federal securities laws.<sup>12</sup>
- In September 2017, the SEC created a new Cyber Unit to focus, among other things, on violations involving distributed ledger technology and ICOs.<sup>13</sup>
- In November 2017, Chair Clayton, speaking at an Institute on Securities Regulation conference said, “I have yet to see an ICO that doesn’t have a sufficient number of hallmarks of a security.... There is also a distinct lack of information about many online platforms that list and trade virtual coins or tokens offered and sold in ICOs.”<sup>14</sup>
- In December 2017, Chair Clayton in an official SEC “Statement on Cryptocurrencies and Initial Coin Offerings” warned Main Street investors: “By and large, the structures of [ICOs] that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws.”<sup>15</sup>
- In January 2018, Chair Clayton at the Securities Regulation Institute relayed a “simple” and “stern” message to securities lawyers not to help clients structure cryptocurrency offerings with many key features of securities offerings but advise the

clients that these products were not securities; he said the SEC staff would be on “high alert” for advice that ran contrary to the “spirit of our securities laws and the professional obligations of the U.S. securities bar.”<sup>16</sup>

- In February 2018, Chair Clayton testified before the Senate Banking, Housing and Urban Affairs Committee, opining: “I believe every ICO I have ever seen is a security.... ICOs that are securities offerings, we should regulate them like we regulate securities offerings. End of story.”<sup>17</sup>
- In March 2018, the SEC’s “Statement on Potentially Unlawful Online Platforms for Trading Digital Assets,” warned investors about unregistered online trading platforms trading virtual currencies and offered a lengthy list of questions investors should ask before trading on such platforms.<sup>18</sup>
- In April 2018, Chair Clayton spoke at Princeton University on “Cryptocurrency and Initial Coin Offerings,” noting that while not all ICOs were fraudulent, the SEC must stop the ICO fraudsters in order to help the ICO industry mature overall.<sup>19</sup>
- In May 2018, the SEC set up a fake ICO website—*howey-coins.com*—complete with phony celebrity promoters that purported to be the “only coin offering that captures the magic of coin trading profits and the excitement and guaranteed returns of the travel industry” on an SEC-compliant exchange registered with the U.S. government. Through this website, the SEC has sought to educate the investing public about the various methods of fraud used in similar offerings.
- In June 2018, William Hinman, director of the SEC’s Division of Corporate Finance, spoke at the Yahoo Finance All Markets Summit: Crypto and reemphasized that central to determining whether cryptocurrency is being sold as a security is whether it is part of an investment to nonusers by promoters to develop the enterprise.<sup>20</sup> However, he made clear that when there is no longer any central enterprise being invested in—as with Bitcoin or Ether—or when the digital asset is sold only to be used to purchase a good or service available through the network on which it was created, the sale of such digital asset most likely does not constitute a security.<sup>21</sup>

On the enforcement side, the SEC has brought enforcement actions relating to virtual currency against Ponzi schemers and fraudulent, unregistered virtual currency and ICO promoters. In July 2013, it filed its first action in *SEC v. Shavers*<sup>22</sup> against an individual who allegedly ran a Ponzi scheme based on Bitcoin-dominated investments. While the defendant argued that the SEC lacked jurisdiction since the Bitcoin investments did not constitute securities, the court held that the transactions met the *Howey* test as an investment contract subject to the SEC’s jurisdiction.<sup>23</sup> Since *Shavers*, the SEC has brought numerous other enforcement cases focused on registration failures by operators of virtual currency-related enterprises.<sup>24</sup>

Since late 2017, the SEC has brought numerous enforcement actions relating to ICOs. For example, in September 2017, the SEC filed a complaint against two companies and their owner, Maksim Zaslavskiy, for fraudulent conduct relating to two ICOs that offered tokens for diamond and real estate investments with promises of high profits, even though neither company had “any real operations,” lacked any of the purported “team of lawyers,” and could not pay investors any returns.<sup>25</sup> In November 2017, the U.S. Department of Justice (DOJ) charged Zaslavskiy with federal criminal securities fraud and conspiracy violations in connection with his alleged fraudulent cryptocurrency ICO scheme.<sup>26</sup> In December 2017, the SEC obtained an emergency asset freeze to halt an ICO fraud by repeat securities law violator Dominic Lacroix that raised up to \$15 million from thousands of investors in four months by promising a 1,354 percent profit in less than

29 days.<sup>27</sup> Also, in December 2017, the SEC obtained a cease-and-desist order against California-based Munchee, Inc., a company selling unregistered digital MUN tokens for its blockchain-based food review service through an ICO that touted the efforts by the company to increase the value of the tokens and support a secondary market for them.<sup>28</sup>

In April 2018, the SEC and DOJ brought parallel civil and criminal cases against two Florida men who solicited investments in a \$32 million ICO for the Centra Token that falsely claimed it was backed by major payment processors like Visa, MasterCard, and Bancorp.<sup>29</sup> The defendants are alleged to have completely fabricated two company executives on its website, promised a fictional dividend, and paid celebrities (music producer DJ Khaled and former boxing champion Floyd Mayweather) to promote the Centra ICO.<sup>30</sup>

More recently, in September 2018, the SEC filed securities charges against an international securities dealer, 1pool Ltd., aka 1Broker, and its Austria-based CEO Patrick Brunner in connection with security-based swaps funded with bitcoins.<sup>31</sup> “International companies that transact with U.S. investors cannot circumvent compliance with the federal securities laws by using cryptocurrency,” said Shamoil Shipchandler, SEC Director of the Fort Worth Regional Office.<sup>32</sup>

Understanding that it stands on the precipice of exponential growth of cryptocurrency transactions and ICOs, the SEC has shown that it will prosecute aggressively those who operate fraudulent cryptocurrency schemes, shut down expeditiously those who fail to register virtual currency securities and to license virtual currency platforms and exchanges, and advise proactively the investing public about the dangers they face from cryptocurrency investments. However, as SEC Chair Clayton has acknowledged, the SEC lacks authority over transactions in currencies or commodities, including currency trading platforms, as well as over utility tokens that do not have the hallmarks of securities.<sup>33</sup> As such, the SEC’s ability to regulate and enforce its laws in the cryptocurrency world is necessarily limited, requiring it to work with other agencies and/or seek enhanced jurisdiction from Congress.

**T**he CFTC has taken the position that virtual currency is a commodity and therefore subject to its oversight under the Commodity Exchange Act (CEA).<sup>34</sup> On March 6, 2018, the CFTC’s cryptocurrency jurisdiction was confirmed in *CFTC v. Patrick K. McDonnell and Cabbagetech, Corp. dba Coin Drop Markets*, a case in which the CFTC had sued the defendants under the CEA for operating a deceptive and fraudulent virtual currency scheme.<sup>35</sup> The defendants argued that the CFTC lacked authority to regulate cryptocurrency as a commodity or exercise its jurisdiction over fraud that does not directly involve the sale of futures or derivative contracts. U.S. District Judge Jack Weinstein ruled that since virtual currencies were “goods” exchanged in a market for a uniform quality and value, they fell well within the common definition of “commodity” under the CFTC’s jurisdiction.<sup>36</sup> Recently, in October 2018, a Massachusetts district court in *CFTC v. My Big Coin Pay, Inc.*,<sup>37</sup> confirmed the CFTC’s authority to regulate virtual currency as a “commodity” under the CEA even when there were no current futures contracts for the virtual currency.

While the SEC and CFTC have overlapping jurisdictions, rather than compete, they have publicly stated their commitment to coordinate on enforcement efforts in the virtual currency arena. SEC Chair Clayton and CFTC Chair J. Christopher Giancarlo, in a show of coordinated action, jointly penned an article in *The Wall Street Journal* on January 24, 2018, stating: “The CFTC and SEC, along with other federal and state regulators and

criminal authorities, will continue to work together to bring transparency and integrity to these [cryptocurrency] markets and, importantly, to deter and prosecute fraud and abuse.”<sup>38</sup> This statement of coordination in virtual currency enforcement actions echoed the statement issued the week before by the SEC and CFTC Enforcement Directors.<sup>39</sup> Indeed, the CFTC has formed an internal virtual currency enforcement task force that has worked cooperatively with its counterparts at the SEC.<sup>40</sup>

Since late 2017, the CFTC has aggressively brought numerous enforcement actions against virtual currency defrauders. In September 2017, it brought its first virtual currency anti-fraud enforcement action involving Bitcoin against Gelfman Blueprint, Inc. and its chief executive officer Nicholas Gelfman for operating a Bitcoin Ponzi scheme that obtained more than \$600,000 from at least 80 customers by falsely promising to employ a high-frequency, algorithmic trading strategy to trade Bitcoin and then misrepresenting the results of the strategy.<sup>41</sup> Then, in January 2018, the CFTC brought three cryptocurrency enforcement actions against: 1) My Big Coin Pay, Inc., which charged the defendants with commodity fraud and misappropriating over \$6 million from customers through its sale of a virtual currency (My Big Coin) by, among other things, transferring customer funds into personal bank accounts and using those funds for personal expenses and the purchase of luxury goods;<sup>42</sup> 2) The Entrepreneurs Headquarters, Ltd., which charged the defendants with engaging in a fraudulent scheme to solicit Bitcoin and making Ponzi-style payments to commodity pool participants from other participants’ funds, among other allegations;<sup>43</sup> and 3) CabbageTech, Corp., which charged the defendants with fraud and misappropriation in connection with purchases and trading of Bitcoin and Litecoin.<sup>44</sup>

Not only has the CFTC actively engaged in enforcement actions, it also has encouraged the growth of regulated virtual currency derivatives (futures, options and swaps) trading platforms. In 2016, just one year after sanctioning the same trading platform for wash trading, the CFTC granted formal registration to TeraExchange, an early entrant in the market for Bitcoin financial derivatives.<sup>45</sup> In July 2017, the CFTC approved LedgerX LLC, the first federally regulated Bitcoin options exchange platform in the United States.<sup>46</sup> In December 2017, the CFTC allowed the CME Group Inc. and Cboe Global Markets Inc. to start offering Bitcoin futures, an action that helped spike an 80 percent jump in the spot market.<sup>47</sup>

Like the SEC, the CFTC has recognized the limitations of its authority as it does not have jurisdiction under the CEA over markets or platforms conducting cash or “spot” transactions in virtual currencies or over participants on such platforms; indeed, no U.S. federal regulator has any oversight authority over spot virtual currency platforms in the United States or abroad.<sup>48</sup> Without such authority in these areas, the CFTC cannot impose registration requirements, surveillance and monitoring, transaction reporting, capital adequacy, trading system safeguards, or cyber security examinations on the participants.<sup>49</sup>

**F**inCEN, a federal agency in charge of protecting the integrity of the U.S. financial system, has joined other federal regulators to assert authority to regulate virtual currency pursuant to its mandate under the Bank Secrecy Act (BSA) to police money laundering. Like other government enforcers, FinCEN proclaims its desire to “promote the positive financial innovations associated with [virtual currency’s] technology, while protecting our financial system from criminals, hackers, sanctions-evaders, and hostile foreign actors.”<sup>50</sup> In guidance issued in March 2013, FinCEN classified persons who create, obtain, distribute, exchange, accept, or transmit virtual currencies

into three groups: users, administrators, and exchangers.<sup>51</sup> Users who obtain virtual currency and use it to purchase real or virtual goods or services are not subject to FinCEN's regulations. Administrators who engage as a business in issuing, putting into circulation, or redeeming a virtual currency, and exchangers who engage as a business in the exchange of virtual currency for traditional currency, funds, or other virtual currency, are subject to the full panoply of FinCEN's registration, reporting, and record-keeping requirements for "money services businesses" (MSBs). Those MSB requirements include registration, know your customer (KYC) regulations, anti-money laundering (AML) programs, obtaining customer identification information, and filing suspicious activity and currency transaction reports.<sup>52</sup>

FinCEN has taken an expansive view of the type of activity that falls under its jurisdiction. In an advisory ruling in October 2014, FinCEN stated that a virtual currency trading platform that matched buyers and sellers of virtual currency acted as a money transmitter subject to FinCEN's regulations, even though the trading platform did not transact directly with either party and served only as facilitating broker.<sup>53</sup> FinCEN explained that the "method of funding the transactions is not relevant to the definition of money transmitter" and that the term encapsulates any person that accepts currency in whatever form "with the intent and/or effect of transmitting" currency in whatever form to another person or location.<sup>54</sup> Thus, any entity that plays a role in the movement of virtual currency from one party to another may be subject to FinCEN's jurisdiction.

The power of FinCEN's MSB requirements to mandate administrators and exchangers of virtual currency to obtain identification information of the virtual currency's user and source of funds is that they provide law enforcement with the ability to work its way through the blockchain to track down the actual person identified in potentially illegal cryptocurrency transactions. FinCEN regularly receives over 1,500 Suspicious Activity Reports (SARs) per month from MSBs and financial institutions describing potentially illegal activity involving virtual currency.<sup>55</sup> This illicit activity has encompassed abusing virtual currency to facilitate cybercrime, black market sales of illicit products and services, and other high-tech crimes. FinCEN maintains a team of analysts to examine BSA filings from virtual currency MSBs including filings pertaining to digital coins, tokens, and ICOs to "proactively identify trends and risks for money laundering, terrorist financing, and other financial crimes, and provide this information to U.S. law enforcement and other government agencies."<sup>56</sup> These analysts also have worked with the IRS to comprehensively examine to date approximately one-third of the over 100 virtual currency exchangers and administrators that have registered with FinCEN.

In addition to these examinations, starting in 2015, FinCEN has brought significant enforcement actions against exchanges and individuals who operate exchanges. In May 2015, FinCEN initiated its first action against a U.S. virtual currency exchange, Ripple Labs, over allegations that Ripple Labs failed to register as a MSB in connection with selling its virtual currency, XRP, and failed to maintain an AML program. Ripple Labs agreed to pay a civil money penalty of \$700,000 and also resolved potential criminal charges with the DOJ by forfeiting \$450,000.<sup>57</sup> In 2015, the FinCEN working with the DOJ brought criminal charges against Anthony Murgio and his co-conspirators for operating Coin.mx, an unregistered Internet-based Bitcoin exchange, through which he processed more than \$10 million in illegal bitcoin transactions; he pled guilty and in June 2017 was sentenced to 5½ years in prison.<sup>58</sup> In July 2017, FinCEN brought its first case against a foreign virtual currency exchanger, BTC-e, and assessed its largest penalty to date—\$110 million—against BTC-e for vio-

lating U.S. AML laws.<sup>59</sup> BTC-e was one of the largest virtual currency exchangers by volume in the world and facilitated transactions involving ransomware, computer hacking, identity theft, tax refund fraud schemes, public corruption and illegal drug sales on dark net markets like Silk Road, Hansa Market, and Alpha-Bay.<sup>60</sup> FinCEN coordinated with the DOJ, IRS, FBI, U.S. Secret Service, and Homeland Security Investigations to bring criminal charges of money laundering and operating an unlicensed money service business with a potential sentence of well over 10 years' imprisonment against Alexander Vinnik, one of BTC-e's operators, and assess him a \$12 million penalty.<sup>61</sup> This action leaves no doubt that FinCEN is willing to pursue virtual currency activity that subverts U.S. law, regardless of where the offender is incorporated or domiciled.

FinCEN also has worked in tandem with state licensing authorities around the country to regulate those who are permitted to handle people's virtual currency. These state money transmitting licensing regimes typically require detailed information about the cryptocurrency exchange's business plans, financial statements, and compliance and cybersecurity programs, as well as requiring the entity to be bonded and have the executives submit to background checks and regular auditing. For instance, starting in 2015, New York instituted a "BitLicense," a business license that covers substantially all "virtual currency business activity" to the extent it touches New York or its residents. Through March 2018, however, the New York Department of Financial Services had only issued four BitLicenses, after a comprehensive review of each company's anti-money laundering, capitalization, consumer protection and cybersecurity policies.

Given the overlapping jurisdictions and gaps in enforcement, there are many steps that Congress and law enforcement agencies can take to address the potential cryptocurrency-related crimes, ranging from Ponzi and other fraudulent schemes to tax evasion, money laundering, terrorist financing, and outright theft. On one extreme, the U.S. can follow the enforcement and regulatory models of countries like Bangladesh, Bolivia, Ecuador, Kyrgyzstan, Morocco, Nepal, Vietnam, and, more recently, China and South Korea that have banned cryptocurrencies and/or shut down virtual currency online exchanges and ICOs completely.<sup>62</sup> Such a black-and-white enforcement model offers certain immediate advantages since it does not require lengthy and detailed examinations of virtual currency exchangers or online trading platforms or a taxpayer's basis in a virtual currency—it simply bans and criminalizes all actions associated with cryptocurrencies. It is a strategy consistent with that adopted by certain financial institutions like Bank of America, Citigroup, Lloyds Banking Group, and J.P. Morgan Chase, all of which have agreed to no longer allow cryptocurrencies to be purchased with their credit cards.<sup>63</sup> Internet companies, like Google, Facebook and Twitter, also have stated that they will ban all online advertisements for cryptocurrencies. The disadvantages of this "complete ban" strategy, however, are those repeatedly voiced by all government regulators themselves. Since this financial technology has the potential, if properly regulated, to revolutionize financial markets and bring increased transparency, efficiency, and access not only to Wall Street but also to Main Street investors and consumers, completely banning virtual currencies will stunt innovation and divert these currencies onto unregulated, unlicensed platforms and facilitate illicit uses.

Another enforcement path lies with Congress either providing greater jurisdiction to the SEC, CFTC, and FinCEN to address the gaps in their oversight or creating a new agency, like a Cryptocurrency Exchange Commission (CEC), and invest it with



powers to cover all aspects of virtual currency transactions.<sup>64</sup> Such an agency would not have the SEC's limitations of being unable to regulate utility tokens or money transmission businesses, the CFTC's lack of jurisdiction to regulate participants, markets, or platforms conducting cash or "spot" transactions in virtual currencies, or FinCEN's inability to impose uniform national regulation and enforcement of money services businesses currently subject to the myriad of state licensing regimes. This type of an agency would be able to better centralize policy-making and enforcement, work with domestic constituents and its international counterparts since virtual currencies know no boundaries, and provide clearer and more enhanced protections to consumers and participants in the cryptocurrency world going forward.<sup>65</sup> Congress created the SEC in 1934 to implement greater federal regulation of the securities market, while the CFTC was formed in 1974 to improve regulation of the futures and options markets and the FinCEN was established in 1990 to combat money laundering, terrorist financing and other financial crimes. Now, it is time for Congress to create the CEC as the federal "crypto-sheriff" to strike the right balance in reining in the Wild West of Cryptocurrency.

As CFTC Chair Giancarlo accurately expressed, such a balance is crucial in taking advantage of the potential that cryptocurrency has to offer while mitigating its downside risks:

We are entering a new digital era in world financial markets. As we saw with the development of the Internet, we cannot put the technology genie back in the bottle. Virtual currencies mark a paradigm shift in how we think about payments, traditional financial processes, and engaging in economic activity. Ignoring these developments will not make them go away, nor is it a responsible regulatory response.... With the proper balance of sound policy, regulatory oversight and private sector innovation, new technologies will allow American markets to evolve in responsible ways and continue to grow our economy and increase prosperity.<sup>66</sup> ■

Futures Trading Commission, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Feb. 6, 2018), available at <https://www.banking.senate.gov/imo/media/doc/Clayton%20Testimony%202-6-18.pdf> [hereinafter Clayton Testimony].

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* Indeed, the total value of all Bitcoin is approximately \$130 billion (based on a Bitcoin price of \$7,700) which is approximately the same as a single "large cap" business like McDonalds (around \$130 billion). While the total value of all outstanding virtual currencies is estimated to be about \$365 billion, the total value of all gold in the world is estimated to be about \$8 trillion. See testimony of CFTC Chair J. Christopher Giancarlo before Senate Banking Committee (Feb. 6, 2018), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo37> [hereinafter Giancarlo Testimony].

<sup>7</sup> Letter from Mary Jo White, SEC Chair, to Hon. Thomas P. Carper, Chairman, Senate Committee on Homeland Security and Governmental Affairs (Aug. 30, 2013), available at <http://online.wsj.com/public/resources/documents/VCurrenty111813.pdf>.

<sup>8</sup> SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946).  
<sup>9</sup> *Id.* at 299.

<sup>10</sup> *Tcherepin v. Knight*, 389 U.S. 332, 336 (1967). See SEC Chair Jay Clayton, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11> [hereinafter Clayton Statement]. SEC Chair Clayton emphasized how the substance of the virtual currency rather than its label as a token or currency will control, e.g., if a token represents a participation interest in a book-of-the-month club, that may not implicate the securities laws and be an efficient way to fund the future acquisition of books for token holders. However, if the token is more analogous to an interest in a yet-to-be-built publishing house with the authors, books and distribution networks all to come and the offering emphasizes the secondary market trading profit potential of the tokens based on the efforts of others, these are key hallmarks of a security and securities offering.

<sup>11</sup> Investor Bulletin: Initial Coin Offerings, Investor Alerts and Bulletins, SEC (July 25, 2017), [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib\\_coinofferings](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings).

<sup>12</sup> Press Release, SEC No. 2017-131, SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities (July 25, 2017), available at <https://www.sec.gov/news/press-release/2017-131>.

<sup>13</sup> Press Release, SEC No. 2017-176, SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors (Sept. 25, 2017), available at <https://www.sec.gov/news/press-release/2017-176>.

<sup>14</sup> Dave Michaels & Paul Vigna, *SEC Chief Fires Warning Shot against Coin Offerings*, WALL ST. J., Nov. 9, 2017, available at <https://www.wsj.com/articles/sec-chief-fires-warning-shot-against-coin-offerings-1510247148>. Joseph Grundfest, a former SEC commissioner, echoed SEC Chair Clayton's warning about ICOs: "ICOs represent the most pervasive, open and notorious violation of the federal securities laws since the Code of Hammurabi." Nathaniel Popper, *Initial Coin Offerings Horrify a Former SEC Regulator*, N.Y. TIMES, Nov. 26, 2017, available at <https://www.nytimes.com>.

<sup>15</sup> Clayton Statement, *supra* note 10.

<sup>16</sup> Opening Remarks of SEC Chair Jay Clayton at the Securities Regulation Institute (Jan. 22, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-012218>.

<sup>17</sup> Stan Higgins, *SEC Chief Clayton: "Every ICO I've Seen Is a Security"*, Coindesk, Feb. 6, 2018, <https://www.coindesk.com/sec-chief-clayton-every-ico-ive-seen-security>.

<sup>18</sup> SEC Public Statement on Potentially Unlawful Online Platforms for Trading Digital Assets (Mar. 7, 2018), available at <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>.

<sup>19</sup> Nikhilesh De & Mahishan Gnanaseharan, *SEC Chief Touts Benefits of Crypto Regulation*, Coindesk, Apr. 6, 2018, <https://www.coindesk.com/sec-chief-not-icos-bad>.

<sup>20</sup> Speech of William Hinman, Director, SEC Division of Corporate Finance, Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018), available at <https://www.sec.gov/news/speech/speech-hinman-061418>.

<sup>21</sup> *Id.*

<sup>22</sup> SEC v. Shavers, No. 4:13-CV-416, 2013 WL 4028182 (E.D. Tex. Aug. 6, 2013).

<sup>23</sup> *Id.* at \*2.

<sup>24</sup> See, e.g., In re Erik T. Voorhees (Order Instituting Cease-and-Desist Proceedings, June 3, 2014), available at <https://www.sec.gov/litigation/admin/2014/33-9592.pdf> (sanctioning the co-owner of two websites for soliciting investments in offerings of unregistered securities valued in Bitcoin); In re BTC Trading, Corp., et al., (Order Instituting Cease-and-Desist Proceedings, Dec. 8, 2014), available at <https://www.sec.gov/litigation/admin/2014/33-9685.pdf> (sanctioning operator of two online platforms that traded securities using virtual currency without registering them as broker-dealers or stock exchanges); In re Sand Hill Exchange, et al., (Order Instituting Cease-and-Desist Proceedings, June 17, 2015), available at <https://www.sec.gov/litigation/admin/2015/33-9809.pdf> (sanctioning a company that accepted virtual currency in connection with the purchase and sale of complex derivatives products outside the regulatory framework of a national securities exchange and without the required registration statements).

<sup>25</sup> Press Release, SEC No. 2017-185, SEC Exposes Two Initial Coin Offerings Purportedly Backed by Real Estate and Diamonds (Sept. 29, 2017), <https://www.sec.gov/news/press-release/2017-185-0>.

<sup>26</sup> *United States v. Zaslavskiy*, No. 1:17-cr-00647-RJD (E.D. N.Y. Nov. 21, 2017), available at <https://ia802803.us.archive.org/35/items/gov.uscourts.nyed.409850/gov.uscourts.nyed.409850.7.0.pdf>. In September 2018, the court rejected Zaslavskiy's argument in his motion to dismiss that he could not be charged with securities fraud because the digital tokens he sold were not securities. *Id.*, Doc. 37, Memorandum & Order (Sept. 11, 2018).

<sup>27</sup> Press Release, SEC No. 2017-219, SEC Emergency Action Halts ICO Scam (Dec. 4, 2017), available at <https://www.sec.gov/news/press-release/2017-219>.

<sup>28</sup> Press Release, SEC No. 2017-227, Company Halts ICO after SEC Raises Registration Concerns (Dec. 11, 2017), available at <https://www.sec.gov/news/press-release/2017-227>.

<sup>29</sup> *United States v. Sohrab Sharma and Robert Farkas*, No. 18 Mag 2695 (S.D. N.Y. Mar. 31, 2018); SEC v. Sohrab Sharma and Robert Farkas, No. 1:18-cv-02909 (S.D. N.Y. April 2, 2018).

<sup>30</sup> Jody Godoy, *Crypto "Visa" Card Duo Accused of \$32M ICO Fraud*, LAW360 (Apr. 3, 2018), <https://www.law360.com/articles/1029085/crypto-visa-card-duo-accused-of-32m-ico-fraud>.

<sup>31</sup> SEC v. IPool Ltd a.k.a. 1Broker and Patrick Brunner, Case No. 1:18-cv-02244 (Sept. 27, 2018), available at <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-218.pdf>.

<sup>32</sup> Press Release, SEC Charges Bitcoin-Funded Securities Dealer and CEO (Sept. 27, 2018), available at <https://www.sec.gov/news/press-release/2018-218>.

<sup>33</sup> Clayton Testimony, *supra* note 4.

<sup>34</sup> See In re Coinflip, Inc., et al., CFTC No. 15-29 (Sept. 17, 2015), available at <https://www.cftc.gov/sites>

<sup>1</sup> Tae Kim, *Warren Buffet Says Bitcoin Is "Probably Rat Poison Squared"*, CNBC, May 6, 2018, <https://www.cnbc.com>.

<sup>2</sup> *Id.*

<sup>3</sup> Panos Mourdoukoutas, *Warren Buffett Is Wrong About Bitcoin*, FORBES, May 7, 2018, available at <https://www.forbes.com>.

<sup>4</sup> See testimony of SEC Chairman Jay Clayton, Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity

/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoindroporder09172015.pdf.  
<sup>35</sup> CFTC v. Patrick K. McDonnell, et al., No. 1:18-cv-00361-JBW, Memorandum & Order (E.D. N.Y. Mar. 6, 2018), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoindroporder030618.pdf>.  
<sup>36</sup> *Id.* at \*24.

<sup>37</sup> CFTC v. My Big Coin Pay, Inc., Case No. 1:18-cv-10077-RWZ, Doc. 106 (D. Mass. Sept. 26, 2018), available at <https://www.scribd.com/document/379774783/CFTC-v-My-Big-Coin-Pay-Plaintiff-Opinion-5-18-18>.

<sup>38</sup> Jay Clayton & J. Christopher Giancarlo, *Regulators Are Looking at Cryptocurrency: At the SEC and CFTC We Take Our Responsibility Seriously*, WALL ST. J., Jan. 24, 2018, available at <https://www.wsj.com/articles/regulators-are-looking-at-cryptocurrency-1516836363>.

<sup>39</sup> SEC Public Statement, Joint Statement by SEC and CFTC Enforcement Directors Regarding Virtual Currency Enforcement Actions (Jan. 19, 2018), available at <https://www.sec.gov/news/public-statement/joint-statement-sec-and-cftc-enforcement-directors>.

<sup>40</sup> Giancarlo Testimony, *supra* note 6.

<sup>41</sup> CFTC Release No. 7614-17, CFTC Charges Nicholas Gelfman and Gelfman Blueprint, Inc. with Fraudulent Solicitation, Misappropriation, and Issuing False Account Statements in Bitcoin Ponzi Scheme (Sept. 21, 2017), <https://www.cftc.gov/PressRoom/PressReleases/pr7614-17>.

<sup>42</sup> CFTC Release No. 7678-18, CFTC Charges Randall Crater, Mark Gillespie, and My Big Coin Pay, Inc. with Fraud and Misappropriation in Ongoing Virtual Currency Scam (Jan. 24, 2018), <https://www.cftc.gov/PressRoom/PressReleases/pr7678-18>.

<sup>43</sup> CFTC Release No. 7674-18, CFTC Charges Colorado Resident Dillon Michael Dean and His

Company, The Entrepreneurs Headquarters Limited, with Engaging in a Bitcoin and Binary Options Fraud Scheme (Jan. 19, 2018), <https://www.cftc.gov/PressRoom/PressReleases/pr7674-18>.

<sup>44</sup> CFTC Release No. 7675-18, CFTC Charges Patrick K. McDonnell and His Company CabbageTech, Corp. d/b/a Coin Drop Markets with Engaging in Fraudulent Virtual Currency Scheme (Jan. 19, 2018), <https://www.cftc.gov/PressRoom/PressReleases/pr7675-18>.

<sup>45</sup> Stan Higgins, *CFTC Grants Full Registration to Bitcoin Swaps Trading Platform*, COINDESK, May 26, 2016, <https://www.coindesk.com/us-swap-platform-registration-cftc>.

<sup>46</sup> Michael Del Castillo, *CFTC Formally Registers New Cryptocurrency Swap Execution Facility*, COINDESK, July 7, 2017, <https://www.coindesk.com/bitcoin-ether-cftc-formally-registers-first-cryptocurrency-swap-execution-facility>.

<sup>47</sup> Benjamin Bain, *CFTC Warns of Bitcoin-Futures Dangers, After Allowing Them*, BLOOMBERG, Dec. 15, 2017, available at <https://www.bloomberg.com/news/articles/2017-12-15/cftc-warns-of-dangers-from-bitcoin-futures-after-allowing-them>.

<sup>48</sup> Giancarlo Testimony, *supra* note 6.

<sup>49</sup> *Id.*

<sup>50</sup> Letter from Drew Maloney, Assistant Secretary for Legislative Affairs, U.S. Dep't of Treasury to Senator Ron Wyden (Feb. 13, 2018), available at <https://coincenter.org/files/2018-03/fincen-ico-letter-march-2018-coin-center.pdf> [hereinafter FinCEN Letter].

<sup>51</sup> Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies, FIN-2013-G001, U.S. Dep't Treasury Fin. Crimes Enforcement Network (March 18, 2013), <https://www.fincen.gov>.

<sup>52</sup> *Id.* An MSB must report transactions that the MSB "knows, suspects, or has reason to suspect" are sus-

picious, if the transaction is conducted or attempted by, at, or through the MSB, and the transaction involves or aggregates to at least \$2,000.00 in funds or other assets. A transaction is "suspicious" if the transaction: 1) involves funds derived from illegal activity; 2) is intended or conducted in order to hide or disguise funds or assets derived from illegal activity, or to disguise the ownership, nature, source, location, or control of funds or assets derived from illegal activity; 3) is designed, whether through structuring or other means, to evade any requirement in the Bank Secrecy Act or its implementing regulations; 4) serves no business or apparent lawful purpose, and the MSB knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or 5) involves use of the MSB to facilitate criminal activity. 31 C.F.R. §1022.320(a)(2).

<sup>53</sup> Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Trading Platform, FIN-2014-R011, U.S. Dep't Treasury Fin. Crimes Enforcement Network (Oct. 27, 2014), <https://www.fincen.gov>.

<sup>54</sup> *Id.*

<sup>55</sup> Prepared Remarks of FinCEN Director Kenneth A. Blanco delivered at the 2018 Chicago-Kent Block (Legal) Tech Conference (Aug. 9, 2018), available at <https://www.fincen.gov/news/speeches/prepared-remarks-fincen-director-kenneth-blanco-delivered-2018-chicago-kent-block>.

<sup>56</sup> FinCEN Letter, *supra* note 50.

<sup>57</sup> FinCEN Fines Ripple Labs Inc. in First Civil Enforcement Action against a Virtual Currency Exchanger, U.S. Dep't Treasury Fin. Crimes Enforcement Network (May 5, 2015), <https://www.fincen.gov>. As of 2015, XRP was the second-largest cryptocurrency by market capitalization after Bitcoin.

<sup>58</sup> Press Release, U.S. Dep't Justice, Operator of Unlawful Bitcoin Exchange Pleads Guilty in Multimillion-Dollar Money Laundering And Fraud Scheme (Jan. 9, 2017), <https://www.justice.gov/usao-sdny/pr/operator-unlawful-bitcoin-exchange-pleads-guilty-multimillion-dollar-money-laundering>.

<sup>59</sup> FinCEN Fines BTC-e Virtual Currency Exchange \$110 Million for Facilitating Ransomware, Dark Net Drug Sales, U.S. Dep't Treasury Fin. Crimes Enforcement Network (July 27, 2017), <https://www.fincen.gov/news/news-releases/fincen-fines-btc-e-virtual-currency-exchange-110-million-facilitating-ransomware>.

<sup>60</sup> *Id.*

<sup>61</sup> Press Release, U.S. Dep't Justice, Russian National and Bitcoin Exchange Charged in 21-Count Indictment for Operating Alleged International Money Laundering Scheme and Allegedly Laundering Funds From Hack of Mt. Gox (July 26, 2017), <https://www.justice.gov/usao-ndca/pr/russian-national-and-bitcoin-exchange-charged-21-count-indictment-operating-alleged>. A defendant is presumed innocent until and unless the government proves him guilty beyond a reasonable doubt; an indictment is not evidence and only indicates that a grand jury found by probable cause that the defendant committed the crimes.

<sup>62</sup> Giancarlo Testimony, *supra* note 6, at n.4.

<sup>63</sup> Arjun Kharpal, *UK Bank Lloyds Follows US Counterparts in Banning People from Buying Cryptocurrencies with Credit Cards*, CNBC, Feb. 5, 2018, <https://www.cnbc.com/2018/02/05/lloyds-bans-use-of-credit-cards-to-buy-cryptocurrencies-like-bitcoin.html>.

<sup>64</sup> See Peter J. Henning, *Should Congress Create a Crypto-Cop?*, N.Y. TIMES, Feb. 14, 2018, <https://www.nytimes.com>.

<sup>65</sup> Jennifer Ruther, *The United States May License Bitcoin and Cryptocurrency Exchanges*, Oct. 3, 2017, <https://bankinnovation.net/2017/10/the-united-states-may-license-bitcoin-and-cryptocurrency-exchanges>.

<sup>66</sup> Giancarlo Testimony, *supra* note 6.

  
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