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The Distributed Ledger

Blockchain, Digital Assets and Smart Contracts

Cryptocurrency Provision in Infrastructure Bill Would Impose Obligations on Numerous Industry Participants

On August 10, 2021, the U.S. Senate passed a $1 trillion infrastructure bill aimed at increasing infrastructure funding over the next eight years. To connect it to increased tax revenue to help pay for these expenditures, the Senate included a provision imposing reporting requirements on cryptocurrency "brokers," with estimates that such reporting would allow the Internal Revenue Service (IRS) to collect an additional $28 billion in tax revenue over ten years. However, the broad definition of "broker" sparked significant backlash throughout the cryptocurrency community, resulting in an unusual few days of proposals and counterproposals. While the short-term result was that the original definition remained in place, the debate marked the most serious consideration of a cryptocurrency issue by either chamber of Congress to date.

Broad Definition of "Brokers"

The cryptocurrency reporting provision in the infrastructure bill is aimed at closing the reporting gap in the current cryptocurrency landscape. Currently, unclear reporting requirements coupled with the difficult in tracing individual cryptocurrency transactions has left a large disparity between the amount of taxes paid on crypto transactions and what is actually owed. The proposed provision of the infrastructure bill sought to address this issue by requiring digital currency "brokers" to report information to the IRS in a 1099 form, including purchase and sales prices and customer information.

While few stakeholders disagreed with the ultimate purpose of the provision, the bill defines a broker as "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." Those in the cryptocurrency community and senators who are more familiar with cryptocurrency transactions quickly criticized the definition as broad and unworkable. As worded, the definition would arguably include a number of industry participants — such as software developers, miners, validators and others involved in a digital currency transaction — who are unable to identify their users. These participants would ostensibly be left with a choice of not complying with the requirement or exiting the market. Critics warned that this could result in pushing these participants out of the U.S. market and into more favorable regulatory environments overseas.

Proposed Amendments

In response to a large and concerted outcry from the cryptocurrency community, Sens. Ron Wyden (D-Ore.), Pat Toomey, R-Pa.) and Cynthia Lummis (R-Wyo.) proposed an amendment that would have excluded from the reporting requirements those cryptocurrency operators who validate transactions, those who develop digital assets or software protocols for use by others, and hardware and software wallet developers. While the fintech community thought this amendment would resolve the issue, the following day, Sens. Rob Portman (R-Ohio), Mark Warner (D-Va.) and Kyrsten Sinema (D-Ariz.) proposed a competing amendment purportedly supported by the Treasury Department and the Biden administration that solely exempted those miners or validators engaged in "proof-of-work" consensus mechanisms (which mechanisms are currently used in the Bitcoin and Ethereum blockchains). Validators or miners participating in other consensus mechanisms, such as "proof-of-stake" (to which Ethereum plans to migrate and which is used by other blockchains), would still be subject to the reporting requirements, as would software developers. The Portman-Warner-Sinema amendment drew even sharper criticism than the original text of the bill since it not only failed to fix the problem of setting attainable reporting requirements, but also exacerbated it by effectively choosing technology winners and losers, imposing reporting requirements on certain technology solutions but not others. After considerable back-channel negotiations, a bipartisan amendment, supported by the Treasury Department, was introduced that would have exempted cryptocurrency participants who validate transactions as well as hardware and software wallet developers. However, the unique procedural posture of the infrastructure bill required unanimous consent. The amendment fell one vote short of such unanimous consent when Sen. Richard Shelby of Alabama objected to the proposal, offering to reserve his objection only if senators included in the legislation his unrelated amendment to increase military spending by about $50 billion. Sen. Bernie Sanders of Vermont voted against the Shelby proposal, and the Senate therefore passed the infrastructure bill with the initial broad definition of "broker."

What's Next?

Members of the House of Representatives have already discussed the need for an amendment to narrow the definition of "broker." Despite these public calls for an amendment, experts say the House is unlikely to amend the bill and risk collapse of the entire infrastructure law by sending it back to the Senate for another vote.

Some lawmakers believe that the Treasury Department will narrow the definition of "broker" through regulations and guidance. The operative provision of the bill explicitly grants the Treasury the regulatory authority to define the scope of the provision. Senators have also attempted to clarify what was actually intended by the legislation, stating that the reporting obligations should only apply to entities that are regularly effectuating transactions of digital assets for consideration. This could strengthen the IRS's ability to effectively narrow the bill's applicability.

Key Takeaways

The ultimate takeaways from the events of the last few weeks will not be known until final guidelines and regulations are in place. However, the intense lobbying effort by the cryptocurrency community was a watershed moment highlighting the industry's growing political influence and its ability, at least for this reporting issue, to unite around a common cause. And, while the compromise amendment failed, debates within the Senate around concepts such as "proof-of-work" and "proof-of-stake" demonstrated a growing sophistication within Congress around cryptocurrency issues and showed that some senators were prepared to advocate on the industry's behalf. As Sen. Luumis noted: "This amendment has started the debate on many difficult questions related to financial technology that the Senate must address over the next few years." Finally, the inclusion of this reporting provision in the bill illustrates both the government's recognition of cryptocurrency as a component of the financial landscape and officials' focus on ensuring that transactions are properly taxed going forward.

Wyoming Passes New Legislation Recognizing DAOs as LLCs

On April 21, 2021, Wyoming Governor Mark Gordon signed Bill 38, allowing the state to legally recognize decentralized autonomous organizations (DAOs) as limited liability companies. The bill was sponsored by Wyoming's Select Committee on Blockchain, Financial Technology and Digital Innovation Technology and took effect on July 1, 2021. Under the law, a DAO must maintain its presence in Wyoming through a registered agent and include proper designation in its articles of organization (self-identifying as a "DAO," "DAO LLC," or "LAO" (Limited Liability Autonomous Organization)). Importantly, the legislation ensures that members of a DAO will not be held personally liable for the debts and liabilities of the company, addressing a concern that a DAO could be construed as a partnership.

DAO Background

Generally, DAOs are decentralized entities that make governance decisions, and implement certain actions through the use of blockchain-based "smart contracts" (*i.e.*, pieces of computer code that execute specified functions when given certain data). DAOs do not have centralized managers or executives. While the DAO "vision" is that such entities could eventually run without any human intervention, today's DAOs are a hybrid of human intervention coupled with automated decision-making. DAOs leverage blockchain technology to memorialize the organizational structure of a corporation by providing mechanisms to record interests in a transparent and decentralized manner.

DAOs are collectively owned and may also be managed by members with a common goal (*i.e.*, a charity, venture fund or community organization). In most cases, prospective DAO members offer some type of contribution (typically cryptocurrency) to join. By investing in a DAO, members receive voting rights and the ability to influence a DAO's operations. Members with significant stakes can make proposals, while decisions are made through consensus on the blockchain.

In the absence of legal entity status and direction from courts or legislators, concern has surfaced among users that DAOs are general partnerships, and therefore each of a DAO's members would be personally liable for the actions (including fraud or material misrepresentations) of the partnership and of the other general partners.

The Wyoming Legislation

Bill 38 extends the Wyoming Limited Liability Company Act to apply to DAOs, granting them the ability to incorporate, transact and hire personnel similarly to a traditional LLC. The bill also permits existing Wyoming LLCs to convert to DAOs.

In order to incorporate, a DAO must have articles of organization or an operating agreement that states the organization is a DAO and includes a statement with the following disclosures:

i. The rights of members in a decentralized autonomous organization may differ materially from the rights of members in other limited liability companies.

ii. The Wyoming Decentralized Autonomous Organization Supplement, underlying smart contracts, articles of organization and operating agreement, if applicable, of a decentralized autonomous organization may define, reduce or eliminate fiduciary duties and may restrict transfer of ownership interests, withdrawal or resignation from the decentralized autonomous organization, return of capital contributions and dissolution of the decentralized autonomous organization.

Notably, the bill permits management of the incorporated DAO to be vested either in its members, if "member managed," or in a smart contract, if "algorithmically managed," unless otherwise provided in the articles of organization or operating agreement. An algorithmically managed DAO must feature an underlying smart contract that can be updated, modified or otherwise upgraded. This distinction between forms of management demonstrates the scope of DAO governance structures that are permissible under the legislation, which may be important as technological advancements allow for greater decentralization. The bill grants flexibility to a DAO's management structure and allows members to experiment with governance through a mix of unique legal agreements, statutory filings or smart contracts.

Bill 38 includes additional provisions that do not apply to traditional LLCs. It specifies that, unlike members of LLCs in many jurisdictions, members of a DAO have no right to inspect or copy its entity's records, to the extent the information is available on a public blockchain. Similarly, a DAO will not be obligated to furnish any information about its activities, financial condition or other circumstances to the extent the information is available on a public blockchain. In addition, in the event that provisions between the articles of organization, operating agreement or the underlying smart contracts conflict, the bill grants deference to a DAO's smart contracts (with a few exceptions, where the smart contract shall not preempt the articles of association, that relate to the definition and election of DAO status and the requirements regarding self-identifying statements and public identifiers). A DAO must be dissolved if it fails to approve any proposals or take any actions after a year. By the order of the secretary of state, a DAO must also be dissolved if it is "deemed to no longer perform a lawful purpose."

The new law also includes specific directives for DAOs. These directives include domiciliation in the state of Wyoming, prohibition of fiduciary duties between members or to the organization (in contrast, most states allow members of traditional LLCs to either establish or waive their fiduciary duties to each other in the operating agreement, even if the arrangement contradicts the default state law), and requirements for the articles of organization (regarding governing relations among members, rights and duties of each member, transferability, voting rights, withdrawal rights, distributions and amendments).

Conclusion

Bill 38 addresses some of the legal questions that DAOs present, such as whether DAOs can be protected from general partnership liability and if the digital codes that operate within smart contracts can serve as legally recognized forms of governance. LLCs could be designed in other states, such as Delaware, to replicate what the Wyoming law provides. However, proponents of the Wyoming law note that it allows DAOs to form more easily and without the complex drafting that might be required in other states.

FinCEN and CFTC Reach Civil Settlement With Cryptocurrency Derivatives Exchange

On August 10, 2021, BitMEX, a cryptocurrency exchange and derivatives trading platform owned and operated by Seychelles-based HDR Global Trading Limited, entered into a global settlement with the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) and the Commodity Futures Trading Commission (CFTC).[1] The settlement resolves civil claims that BitMEX offered cryptocurrency derivatives to U.S. individual and institutional customers without registering with the CFTC, operated a facility to trade or process swaps without being approved as a designated contract market or a swap execution facility, and failed to comply with U.S. anti-money laundering (AML) laws to maintain an adequate AML compliance program. In total, BitMEX paid a $100 million penalty to FinCEN and the CFTC, with $20 million of the FinCEN penalty suspended pending the completion of two independent consultant reviews. Both the CFTC and the Department of Justice (DOJ) proceedings and the DOJ's criminal case against BitMEX's founders, brought in October 2020, remain ongoing.[2]

The Bank Secrecy Act (BSA), as amended, and its implementing regulations mandate that futures commission merchants required to register with the CFTC maintain a program reasonably designed (i) to prevent the financial institution from being used for money laundering or the financing of terrorist activities and (ii) to comply with various AML-related record-keeping and reporting obligations.[3] FinCEN determined that between approximately November 1, 2014, and December 12, 2020, while operating in substantial part in the United States, BitMEX violated the BSA by willfully:

a. failing to implement and maintain a compliant AML program that consisted of policies, procedures and internal controls; training for employees; independent testing; a designated AML officer; and risk-based controls for conducting customer due diligence;

b. failing to implement and maintain a compliant customer identification program; and

c. failing to file Suspicious Activity Reports (SARs), including on numerous transactions involving darknet markets; high-risk jurisdictions; unregistered money services businesses offering enhanced convertible virtual currency (CVC) anonymity services, such as mixing services; and fraud schemes.

FinCEN found that BitMEX's founders, executive officers and other senior leaders at the company were aware of their AML obligations, including through warnings from other U.S.-based financial institutions. FinCEN also found that, despite BitMEX's internal ban on U.S. customers, BitMEX actively ignored signs that U.S. customers traded on its platform and in some cases altered customers' information to mask their locations or advised customers to establish non-U.S. shell companies.

Additionally, the U.S. District Court for the Southern District of New York entered a consent order between the CFTC and BitMEX sanctioning BitMEX for violations of the Commodity Exchange Act (CEA). The CFTC determined that BitMEX operated a platform that solicited and accepted cryptocurrency derivative contracts on Bitcoin, Ethereum and Litecoin blockchains without registering with the CTFC as a futures commission merchant, designated contract market or swap execution facility, and that BitMEX failed adequately to supervise and maintain a system for AML-related compliance, among other violations of the CEA and the CFTC's regulations. In addition to a monetary penalty, the consent order permanently enjoins BitMEX from committing future violations of the CEA by offering, entering into or confirming the execution of derivatives contracts, including futures and swaps, on Bitcoin, Litecoin and Ethereum without registering with the CFTC. As part of the settlement, BitMEX certified that U.S. residents and anyone located, incorporated or otherwise established in the U.S. will not be able to use BitMEX's services moving forward. BitMEX also certified it will not maintain operations in the United States except for information technology and security functions and board member participation.

The FinCEN and CFTC enforcement actions are notable because they make clear that:

- **The legal requirements developed for traditional financial institutions apply equally in the growing digital asset market.** The CFTC determined that by directly providing customers a platform on which to trade cryptocurrency derivatives and soliciting and accepting orders for bitcoin, Litecoin and ether futures contracts, BitMEX facilitated and engaged in retail commodity transactions. Although these transactions involved digital assets rather than other assets classes that traditionally underlie derivatives contracts, the CFTC

[1] Both the FinCEN and CFTC settlement involved several entities operating as an integrated, common enterprise known as BitMEX.

[2] As discussed in the October 2020 edition of The Distributed Ledger: Blockchain Digital Assets and Smart Contracts, the DOJ announced indictments of the founders and some executives of BitMEX for alleged violations of AML requirements under the Bank Secrecy Act.

[3] FinCEN also alleged as a separate basis for the BSA violations that BitMEX failed to comply with the statute's AML program and record-keeping and reporting requirements for money transmitters. A person is not a money transmitter if registered with, and functionally regulated or examined by, the CFTC. As BitMEX was not registered with the CFTC, it was also subject to FinCEN's jurisdiction on this separate basis.

concluded that BitMEX acted as a designated contract market or swap execution facility and was therefore required to register with the trading commission. The BitMEX action is just the latest example of this trend, and we expect traditional financial regulators responsible for enforcing securities, commodity derivatives and AML laws to continue aggressively to assert jurisdiction over cryptocurrency transactions and exchanges.

- **The pseudonymous nature of convertible virtual currency transactions is not an excuse for a lack of appropriate suspicious activity transaction monitoring.** FinCEN found that BitMEX failed to implement any policies, procedures or internal controls to review bitcoin transactions and identify potentially suspicious transactions occurring through its platform, despite the availability of tools to identify the transacting parties by linking wallet addresses controlled by the same user. FinCEN and other financial regulators, including the CFTC, expect financial institutions dealing in CVC to use public information, transactional information on public, immutable CVC ledgers, and internal customer due diligence information to assist in identifying suspicious activity or patterns of suspicious activity occurring through financial institutions.
- **FinCEN is tackling new targets and taking new approaches in its enforcement actions.** The BitMEX action is FinCEN's first enforcement action against an unregistered futures commission merchant. In another first, FinCEN suspended the payment of $20 million of BitMEX's civil penalty if BitMEX successfully completes — in FinCEN's sole judgment — two types of independent consultant reviews. The first review requires an independent consultant to complete a SAR Lookback Review. BitMEX must then file SARs on historical transactions identified in the report. The second review requires an independent consultant to consider and test BitMEX policies, procedures and controls twice to assess whether they are reasonably designed to ensure BitMEX is not operating wholly or in substantial part in the United States.

Furthermore, the BitMEX consent order contains conditions similar to those frequently part of a criminal deferred prosecution agreement or guilty plea. For example, with some exceptions, BitMEX agreed not to dispute the findings of fact and conclusions of law in the order in any future proceeding brought by FinCEN and to provide ongoing cooperation with FinCEN, including by producing documents, in other matters brought by the authority relating to this action. Further, BitMEX must not claim a tax deduction or any tax benefit for payments made to satisfy the civil money penalty, must waive statute of limitations defenses and must not make any public statements contradicting the order. Failure to comply with these conditions can result in FinCEN reopening the enforcement proceedings.

US Litigation Updates

Class Action Complaint Brought Against Dapper Labs Alleges NFTs Are Unregistered Securities

On May 21, 2021, an individual who purchased nonfungible tokens (NFTs) from Dapper Labs, Inc. filed a putative class action complaint, captioned *Friel v. Dapper Labs, Inc., et al*., No. 653134/2021 (Sup. Ct. N.Y. Cnty.), against Dapper Labs and its chief executive officer in New York state court for alleged sales of unregistered securities. Dapper Labs is a Canada-based blockchain-focused technology company that operates the Flow blockchain, on which it offered NFTs called "NBA Top Shot Moments" that depict video clips of highlights from NBA basketball games.

The plaintiff alleges that the NFTs are unregistered securities under the test set forth in the U.S. Supreme Court decision *Securities and Exchange Commission v. W. J. Howey Co*., 328 U.S. 293 (1946) because they are an investment of money in a common enterprise, purchased by investors with an expectation of profits based on the managerial efforts of Dapper Labs, despite the fact that the user agreement specifically states that the NFTs should not be used for investment or speculative purposes. According to the complaint, Dapper Labs "minted" NFTs from video footage of NBA basketball games and facilitated trading of the NFTs on the open market via the Flow blockchain. The plaintiff further alleges that the company prevented investors from promptly withdrawing their funds, with investors sometimes having to wait weeks or months to do so, which artificially inflated the market for the Top Shot Moments NFTs. The plaintiff asserts that these actions constitute violations of Sections 5 and 12(a)(1) of the Securities Act. On behalf of the class, the plaintiff demands rescissory damages for NFTs purchased during the class period of June 15, 2020, to May 21, 2021. On July 7, 2021, Dapper Labs removed the case to the Southern District of New York on the basis of subject matter jurisdiction pursuant to the Class Action Fairness Act of 2005.

The Securities and Exchange Commission (SEC) and some courts have concluded that certain cryptocurrencies may constitute "investment contracts" (and thus "securities") under the *Howey* test. However, whether such reasoning would apply to NFTs like the ones at issue in *Friel* is unclear. The NFT industry will be closely watching how the case develops.

SEC Settles Charges Against Online Trading Platform for Operating an Unregistered Exchange

On August 9, 2021, the SEC settled charges with Poloniex, the operator of a web-based platform that facilitated the buying and selling of digital assets that allegedly constituted unregistered securities. According to the SEC order instituting cease-and-desist proceedings, the trading platform qualifies as an "exchange" under applicable securities laws because it provided the nondiscretionary means for trade orders to interact and be executed. The SEC alleged that beginning in August 2017, Poloniex employees "aggressive[ly]" sought to increase their market share in the trading of digital assets by listing new digital assets on its platform. Poloniex served both U.S. and international users but did not register as a national securities exchange, nor did it qualify for an exemption. The SEC alleged that Poloniex thus violated Section 5 of the Securities and Exchange Act of 1934 as a result.

Despite having an internal process for reviewing digital assets to ensure they were not at "high risk" of being considered securities, Poloniex continued to offer digital assets on its platform that it considered to be at "medium risk" of being considered securities. After conducting an internal review in 2018, Poloniex delisted some "medium risk" digital assets from the platform. According to the SEC, Poloniex continued to offer digital assets that constituted securities after that time. Notably, the SEC's order does not specify which digital assets traded on Poloniex were considered to be securities.

Without admitting to or denying the SEC's allegations, Poloniex agreed to the cease-and-desist order and to pay disgorgement of approximately $8.5 million, a civil penalty of $1.5 million and prejudgment interest of approximately $400,000.

SEC Commissioner Hester M. Peirce dissented from the order, arguing that Poloniex's registration as a securities exchange or as a broker-dealer to operate an alternative trading system (ATS) was not feasible, because from mid-2017 through 2019, the SEC "was moving very cautiously with respect to regulated entities' engagement with crypto assets." She asserted that if Poloniex had attempted to register as an exchange or an ATS, the company likely would have waited for a response from the SEC and the Financial Industry Regulatory Authority indefinitely. Thus, she stated: "Given how slow we have been in determining how regulated entities can interact with crypto, market participants may understandably be surprised to see us come onto the scene now with our enforcement guns blazing and argue that Poloniex was not registered or operating under an exemption as it should have been."

Commissioner Peirce posed a number of questions that the SEC will need to answer in the event a cryptocurrency trading platform attempts to register as an exchange or an ATS, including questions related to the centralization of the platform, the effect of conditions placed on registration permits, whether the platform can trade securities as well as non-securities, how platforms and customers should determine whether digital assets are securities, when securities may become non-securities and the mechanics of registering tokens under the Exchange Act. Commissioner Pierce noted that regulators and the fintech industry need sensible solutions to these questions.

SEC Settles Charges Against Blockchain Credit Partners for Alleged Unregistered Sales of Securities and Misrepresenting the Company's Operations and Profitability

On August 6, 2021, the SEC settled charges against Blockchain Credit Partners and its two founders for purportedly using decentralized finance (DeFi) technology to sell over $30 million of unregistered securities and for misleading investors about the company's operations and profitability. According to the SEC order, Blockchain Credit Partners sold two types of digital tokens on its platform, the DeFi Money Market. One of the tokens, a payment token called mToken, paid 6.25% interest. The other token, DMG, is a governance token that gave holders voting rights and a share of profits. The SEC alleged that DMG holders had the ability to resell the governance tokens for profit in the secondary market.

The SEC order indicates that Blockchain Credit Partners and its founders stated that the tokens would pay interest and profits because the DeFi Money Market purchased "real-world" assets, including car loans, that generated income. Despite knowledge that this was not feasible due to the volatility of the value of the tokens, Blockchain Credit Partners allegedly misled the public by falsely displaying these real-world assets — which it never purchased — on its website. The SEC concluded that Blockchain Credit Partners and its founders violated Section 5 of the Exchange Act, Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and the rules promulgated thereunder. Without admitting to or denying the SEC's findings, Blockchain Credit Partners and its founders consented to a cease-and-desist order and undertakings, and agreed to pay disgorgement of approximately $12.8 million and prejudgment interest of approximately $258,000. Each of the two founders agreed to pay a $125,000 civil penalty and were also given a five-year officer and director bar.

Notably, the SEC explained that labeling DMG as a governance token and mTokens as decentralized did not prevent the agency from concluding that the tokens constituted unregistered securities under the securities laws. As SEC Commissioner Hester M. Peirce explained at an event held by the Chamber of Digital Commerce, Blockchain Credit Partners "is not really a DeFi case," but a case where decentralized finance was simply used as a marketing term to mask a centralized, fraudulent operation. According to the SEC, "[d]etermining whether a transaction involves a security does not turn on labeling … but instead requires an assessment of 'the economic realities underlying a transaction.'"

"The SEC has been wading into thinking about DeFi," Commissioner Peirce said, describing the area as "one that [we], along with many other regulators," are "struggling to get our arms around." She explained that decentralized financial applications present a novel set of problems for regulators, adding that she would like the SEC to provide explicit guidance on how to launch and maintain DeFi projects without violating the securities laws.

Yet Commissioner Peirce acknowledged that a new federal regulatory structure for DeFi applications may take a long time to establish, given that the SEC has declined to create a regulatory structure for centralized cryptocurrency projects. Furthermore, she explained that the SEC currently lacks the expertise to create a regulatory framework for cryptocurrencies broadly and DeFi in general: "If we do [create a new structure], we better do it with people who know this space well and understand the differences from the traditional markets that we're used to dealing with," she said.

SEC Settles Charges Against Operator of Website for Violations of Anti-Touting Provisions of Federal Securities Laws

On July 14, 2021, the SEC settled charges against UK-based Blotics Ltd., formerly doing business as Coinschedule Ltd., for violations of Section 17(b) of the Securities Act. According to the SEC order, Coinschedule operated a website that publicized offerings for digital tokens, claiming to list the "best" initial coin offerings and initial exchange offerings. The website profiled and ranked over 2,500 token offerings.

The SEC determined that the publicized tokens included "securities," and Coinschedule failed to disclose that it received compensation from issuers to profile their tokens. The SEC concluded that failure to disclose this compensation violated the "anti-touting" provisions of the federal securities laws.

Without admitting to or denying the SEC's findings, Blotics agreed to cease and desist from committing or causing any future violations of Section 17(b) of the Securities Act, and to pay $43,000 in disgorgement, plus prejudgment interest, and a civil penalty of $154,434.

The SEC's decision, however, did not provide clear guidance as to whether and when cryptocurrencies qualify as securities. SEC Commissioners Hester M. Pierce and Elad Roisman issued a public statement expressing their disappointment "that the Commission's settlement with Coinschedule did not explain which digital assets touted by Coinschedule were securities, an omission which is symptomatic of [the agency's] reluctance to provide additional guidance about how to determine whether a token is being sold as part of a securities offering or which tokens are securities."

Financial Services Company Faces Scrutiny From State Regulators Over Its Interest-Bearing Cryptocurrency Accounts

On July 19, 2021, the New Jersey Bureau of Securities issued a cease-and-desist order against BlockFi, Inc.; BlockFi Lending, LLC; and BlockFi Trading, LLC, ordering the BlockFi companies to stop offering interest-bearing cryptocurrency accounts that have raised at least $14.7 billion worldwide. BlockFi is a financial services firm that purports to generate revenue through cryptocurrency trading, lending and borrowing and by engaging in proprietary trading. According to the state order, BlockFi, through its affiliates, has been funding its lending and proprietary trading operations at least in part through the sale of unregistered securities in violation of New Jersey's securities laws.

Following New Jersey's lead, on July 20, 2021, the Alabama Securities Commission issued an order to show cause, asking BlockFi to show why the company should not be ordered to cease and desist from making further offers or sales of securities in Alabama. The Alabama Securities Commission alleges that BlockFi has funded cryptocurrency lending in part through the sale of unregistered securities without an exemption from registration of the securities.

On July 22, 2021, a third U.S. state commenced proceedings involving BlockFi. The Texas State Securities Board filed for a cease-and-desist order against BlockFi claiming that the company sold unregistered securities without first being registered as a dealer or agent.

The Vermont Department of Financial Regulation became the fourth state regulator to allege that BlockFi's cryptocurrency interest-earning accounts are unregistered securities in violation of the state's securities laws. On July 22, 2021, the Vermont Department of Financial Regulation asked BlockFi to show why an order should not be entered directing BlockFi to cease and desist offering interest-earning accounts in Vermont and to pay restitution as a condition of the order, including a civil penalty of not more than $15,000 for each violation.

On July 29, 2021, Kentucky joined the ranks of New Jersey, Alabama, Texas and Vermont in raising regulatory concerns over BlockFi's interest-bearing accounts. The Kentucky Department of Financial Institutions issued an emergency cease-and-desist order, ordering BlockFi to stop soliciting or selling any security in Kentucky unless that security is properly registered.

These actions appear to be based on the specific facts and circumstances of BlockFi's platform. Additionally, however, they may suggest that state securities regulators are focused on the proliferation of projects claiming to act as decentralized finance platforms.

SEC Chairman Makes Remarks Before the Aspen Security Forum and to the *Wall Street Journal*

On August 3, 2021, SEC Chairman Gary Gensler spoke about cryptocurrencies at the Aspen Security Forum, expressing his view that some crypto tokens are offered and sold as unregistered "securities" and should be regulated as such. "We have a crypto market now where many tokens may be unregistered securities, without required disclosures or market oversight," he said. This asset class is "rife with fraud, scams and abuse in certain applications," he continued, explaining how this leaves prices open to manipulation and investors vulnerable. "Right now, we just don't have enough investor protection in crypto. Frankly, at this time, it's more like the Wild West," he commented. Chair Gensler therefore "urged staff to continue to protect investors in the case of unregistered sales of securities." He also noted that the SEC will use the full extent of its powers and will pursue more authority from Congress to "prevent transactions, products and platforms from falling between regulatory cracks." He warned that "if we don't address these issues, I worry a lot of people will be hurt."

Chair Gensler also stated that if crypto trading and lending platforms and other decentralized finance platforms offer securities, they fall under the purview of the SEC and must register with the commission unless they meet an exemption.

Remarking on stablecoins, which are crypto tokens pegged to the value of fiat currencies, Chair Gensler expressed concern that they may be used to sidestep anti-money laundering and tax compliance laws and could affect national security. He further stated that stablecoins may also be "securities" and "investment companies" to which federal securities laws apply.

Additionally, Chair Gensler anticipated an increase of filings with regard to exchange-traded funds under the Investment Company Act. He noted that the SEC will look to maximize regulatory protections in the area of cryptoasset custody.

Finally, the chairman expressed that the SEC needs additional congressional authorities to oversee the crypto market. "In my view, the legislative priority should center on crypto trading, lending and DeFi platforms. Regulators would benefit from additional plenary authority to write rules for and attach guardrails to crypto trading and lending," he said.

Similarly, in an August 18, 2021, interview with the *Wall Street Journal*, Chair Gensler explained that some decentralized finance projects have features that make them look like the types of entities the SEC oversees. He highlighted that decentralized finance projects that reward participants with valuable digital tokens or similar incentives could cross a line into activity that should be regulated, regardless of how "decentralized" the platforms say they are. He cited projects featuring "a core group of folks that are not only writing the software, like the open source software" who "often have governance and fees," and identified "some incentive structure for those promoters and sponsors in the middle of this." Therefore, the term DeFi, he said, is "a bit of a misnomer. … These platforms facilitate something that might be decentralized in some aspects but highly centralized in other aspects."

Consequently, Chair Gensler reiterated that he would ask Congress to help legislate a solution to fill regulatory gaps, such as cases in which some digital assets don't fall neatly into an existing regulatory framework.

International Updates

Law Society Responds to Digital Assets Consultation

The Law Society of England and Wales has responded to the Law Commission's Call for Evidence on Digital Assets, which suggests a number of high-level reforms of the law of personal property as it affects digital assets (the Digital Assets Proposal). The Law Society recommends a narrower conception of "digital assets" than the parameters specified in the Digital Assets Proposal, and suggests confining the notion to cryptoassets. While advocating to limit the scope of assets covered by the proposed reforms, the Law Society does support the proposal to create of an entirely new class of personal property for cryptoassets. In the Law Society's view, such a radical departure is warranted given the characteristics of cryptoassets, which make determining whether such assets fall within either of the existing categories of personal property ("things in possession" or "things in action") difficult. The new class of personal property is intended to be the basis for establishing clear property rights in cryptoassets to enable participants in cryptoasset markets to demonstrate ownership and more easily effect legal transfers of ownership. The Digital Assets Proposal will be followed by a consultation paper containing further recommendations for the reform of the law of personal property with respect to digital assets after July 30, 2021.

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