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## Skadden Discusses CFTC Charges That DeFi Developers Facilitated Off-Exchange Trading

*By Alexander C. Drylewski, Stuart D. Levi, David Meister, Daniel Michael, Chad E. Silverman and Peter A. Varlan* September 26, 2023

### Comment

On September 7, 2023, the Commodity Futures Trading Commission (CFTC) issued three enforcement settlement orders against developers of decentralized finance (DeFi) protocols.<sup>1</sup> The orders charge Oryn, Inc., Deridex, Inc., and ZeroEx, Inc. (0x) with illegally offering leveraged and margined retail commodity transactions in digital assets through their DeFi protocols.<sup>2</sup> Oryn and Deridex were also charged for operating as unregistered swap execution facilities and engaging in activities that can only lawfully be performed by registered futures commission merchants (FCMs), and for failing to conduct know-your-customer diligence.<sup>3</sup>

Perhaps most notably, the settlement with 0x suggests that a platform that merely allows leveraged trading in digital assets, even if it does not directly offer or promote such trading, must register with the CFTC as an exchange.

The entities neither admitted nor denied the allegations, but agreed to pay penalties of \$250,000 (Oryn), \$100,000 (Deridex) and \$200,000 (0x).

Although the settlements are not the CFTC's first foray in the DeFi space,<sup>4</sup> they reflect a particularly aggressive enforcement approach in a novel area and sparked a public dissent from one commissioner.

### Background

The backdrop for these actions is the Commodity Exchange Act's (CEA) treatment of retail commodity transactions, defined for these purposes as contracts entered into on a leveraged or margined basis with persons who are not "eligible contract participants," where the underlying commodity is not delivered within 28 days.<sup>5</sup> Such transactions must be conducted on or subject to a board of trade designated or registered by the CFTC as a contract market, which was the key issue here.<sup>6</sup>

### Violations for Offering Leveraged Retail Commodity Transactions

All three of the DeFi protocol developers were charged with offering retail commodity transactions on unregistered platforms to retail customers in the United States.

Oryn's and Deridex's protocols, and the front ends they offered to access those protocols through their websites, directly offered such contracts to retail customers.<sup>7</sup> Although Oryn took steps to block U.S. internet protocol addresses, the CFTC found that was not sufficient to actually block U.S. users from accessing Oryn's protocol through its website, a decentralized exchange and a blockchain explorer.

In contrast to Oryn and Deridex, 0x, was charged with allowing an unaffiliated party to offer retail commodity transactions on its platform rather than for directly offering such contracts itself.<sup>8</sup> Specifically, 0x developed a blockchain-based digital-asset protocol and a user interface that utilized that protocol for peer-to-peer digital-asset trading by unaffiliated third parties.<sup>9</sup>

Among the thousands of digital assets offered on the interface were at least four leveraged tokens, developed and issued by a third party unaffiliated with 0x. In addition to being leveraged, trading in the assets was not limited to eligible contract participants, and did not result in actual delivery of the underlying commodities (bitcoin and ether in this case) within 28 days, rendering them retail commodity transactions under the CEA.<sup>10</sup>

Even though the leveraged trades that constituted retail commodity transactions were offered by an unaffiliated third party, the CFTC charged 0x with engaging in unlawful off-exchange futures dealing, finding 0x “conducted an office or business in the United States for the purpose of soliciting or accepting orders for, or otherwise dealing in, off-exchange leveraged or margined retail commodity transactions.”<sup>11</sup>

The commission was not unanimous in its support for these actions. Commissioner Mersinger issued a dissenting statement as to all of three actions, highlighting that 0x seemingly developed and designed its protocol for lawful purposes (*i.e.*, trading unleveraged spot contracts), but its platform was used by third parties in a way that violated the CEA.<sup>12</sup> Commissioner Mersinger was also critical of what she termed an “Enforcement First” approach by the CFTC in a novel area where the CFTC should instead be first engaging with the public.<sup>13</sup> She also voiced that concern in her dissent to the CFTC’s earlier Ooki DAO enforcement action.<sup>14</sup>

## Takeaways

In holding these entities liable for setting up a DeFi protocol that was intended for lawful spot trading of digital assets but was utilized by third parties for unlawful trading of leveraged digital assets to retail customers, the CFTC has imposed its own broad interpretation on CEA Section 4(a). More enforcement activity in the DeFi space is likely, as the CFTC’s enforcement director has recently stated his intent “for DeFi to be a significant and continuing focus for the [CFTC] Division of Enforcement.”<sup>15</sup>

But it remains to be seen, as noted by Commissioner Mersinger, where precisely the CFTC will draw the line in cases where a DeFi protocol developed for lawful purposes is put to unlawful uses and what factors (*e.g.*, length of time between development and use, amount of activity, etc.) will be considered.<sup>16</sup> This line drawing is particularly critical given that the essence of decentralized protocols is that they operate without the type of centralized control the CFTC would seem to be requiring. In the meantime, developers of DeFi protocols and interfaces to such protocols should be mindful of the CFTC’s aggressive stance when third parties use their platform or interface to offer retail commodity transactions.

## ENDNOTES

1 CFTC Issues Orders Against Operators of Three DeFi Protocols for Offering Illegal Digital Asset Derivatives Trading, [CFTC Release No. 8774-23](#) (Sept. 7, 2023).

2 Order, *In re Oryn, Inc.*, CFTC No. 23-40, at 5–6, (Sept. 7, 2023); Order, *In re ZeroEx, Inc.*, CFTC No. 23-41, at 4, (Sept. 7, 2023); Order, *In re Deridex, Inc.*, CFTC No. 23-42, at 4–5, (Sept. 7, 2023).

3 *Oryn*, at 5–6; *Deridex*, at 5–6.

4 See Order, *CFTC v. Ooki DAO*, No. 3:22-cv-05416-WHO (N.D. Cal. June 8, 2023), ECF No. 68; Statement of CFTC Division of Enforcement Director Ian McGinley on the Ooki DAO Litigation Victory, [CFTC Release No. 8715-23](#) (June 9, 2023).

5 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa) (exempting contracts of sale that result in actual delivery within 28 days from the definition of retail commodity transaction); see also Final Interpretive Guidance, Retail Commodity Transactions Involving Certain Digital Assets, 85 FR 37734, 37737–38 (June 24, 2020).

6 *Id.* § 6(a).

7 *Oryn*, at 6; *Deridex* at 5.

8 *ZeroEx*, at 4.

9 *Id.* at 3.

10 *Id.*

11 *Id.* at 4.

12 Dissenting Statement of Commissioner Summer K. Mersinger Regarding Enforcement Actions Against: 1) *Oryn, Inc.*; 2) *Deridex, Inc.*; and 3) *ZeroEx, Inc.* (Sept. 7, 2023).

13 *Id.*

14 Dissenting Statement of Commissioner Ian McGinley, [https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcginley1?utm\\_source=govdelivery](https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcginley1?utm_source=govdelivery) “Enforcement by Enforcement: The CFTC’s Actions in the Derivatives Markets for Digital Assets,” (Sept. 11, 2023).

16 *Id.*

*This post comes to us from Skadden, Arps, Slate, Meagher & Flom LLP. It is based on the firm’s memorandum, “CFTC Charges DeFi Developers With Facilitating Off-Exchange Trading,” dated September 20, 2023, and available [here](#).*

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