

Blockchain+ Bi-Weekly November 16, 2023

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The Blockchain Bi-Weekly presented by the Polsinelli Blockchain+ team is a rundown of some of the key stories in the Web3, blockchain and crypto ecosystems curated by our attorneys navigating the intersections of code, smart contracts, and US law.

As the end of the year approaches, the biggest news story was founder of the now defunct FTX cryptocurrency exchange, Sam Bankman-Fried (“SBF”), being found guilty on all counts in the criminal trial brought against him in the wake of the exchange’s collapse. The SEC stayed busy in their digital asset enforcement actions responding in opposition to cryptocurrency exchange Binance’s request for an early dismissal and bringing new actions with the DOJ against the founders and executives involved in the SafeMoon project.

But while these allegations of digital asset fraud dominated the headlines, traditional financial firms have quietly begun taking steps to expand their cryptocurrency-backed ETF offerings and the Presidential Executive Order on AI mentioned

cryptographic proofs as an essential tool to preserve privacy in an increasingly digital world.

These developments and a few other brief notes are discussed below.

~~SafeMoon: November 1, 2023~~ DOJ and SEC

Background: The SEC has brought a civil action against SafeMoon LLC and executives Kyle Nagy, John Karony and Thomas Smith for securities fraud and unregistered sales of securities. At the same time, the DOJ has also brought criminal securities fraud, wire fraud and money laundering charges against Nagy, Karony and Smith.

Summary: SafeMoon previously faced private securities fraud actions last year, so this is not the first time these founders have faced legal challenges to their project. However, while the SEC has been active in the space, the DOJ has largely refrained from bringing criminal actions except in the most egregious situations and the allegations in the complaints here are serious, even if currently unproven. One important takeaway is the amount of marketing statements that the SEC and DOJ relied on to support their securities fraud claims, underscoring the importance of legal compliance training for social media managers involved in projects.

~~Guilty Ben Art & Friends: November 3, 2023~~ End;

Background: SBF's defense team closed out their defense on October 31, and the trial reached its conclusion with jury instructions set and closing arguments concluded. After these weeks of litigation, it only took the jury just a few hours to come back with a guilty verdict on all counts. These verdicts carry a maximum sentence of 110 years, with sentencing scheduled for March 28, 2024. There is also still a trial scheduled for next year on five more charges, plus potential

state criminal charges to come.

Summary: While there is still sentencing left and there will almost certainly be appeals and ongoing actions, it is a relief for the industry to have the SBF saga **mostly in the rearview mirror**. His fraud was a stain on the digital asset industry, so this seems cathartic for it to be over. As **the prosecutor stated** in closing “This is not about complicated issues of cryptocurrency. It’s not about hedging. It’s not about technical jargon. It’s about deception, it’s about lies, it’s about stealing, it’s about greed.”

~~November 7, 2023~~ CFPB Proposed Digital Wallet Regulations:

Background: The CFPB has proposed **new federal oversight rules** for non-banks which provide digital wallet or payment applications. Read the proposed rule and request for public comment **here**. In the release announcing the proposal, CFPB Director Rohit Chopra stated "Today's rule would crack down on one avenue for regulatory arbitrage by ensuring large technology firms and other nonbank payments companies are subjected to appropriate oversight." House Financial Services Committee Chair Patrick McHenry **released a statement** vehemently opposing the proposed rule.

Summary: The CFPB estimates that this rule will affect 17 non-bank financial institutions, but of course, it doesn't name those and the definitions are broad enough that this number seems low. Assumedly they only mean to encompass **payment processors in the traditional sense without focusing on digital assets**, but they expressly include bitcoin transfers as a payment so any company which allows for digital asset transfers would seemingly also fall in these rules.

~~November 7, 2023~~ SEC Report 2023 Binance Motion to Dismiss:

Background: **The SEC has responded** to the **Motions to**

Dismiss filed by the **various Binance entities** back in September. While Binance was sued a day before Coinbase, due to some strategic lawyering from Coinbase's attorneys, Coinbase has led the way in the briefing on the cryptocurrency exchange litigation. This latest briefing kept with that theme with the SEC largely restating the points they made against Coinbase in its case against Binance.

Summary: The SEC predictably led with their arguments that **securities laws are intentionally flexible**, without stating any actual limiting principal on what separates a security from something that a person subjectively buys with at least some profit motivations (like a car, house, our countless other assets which value largely comes from actors other than the purchaser/owner). Interestingly, on page 47 of the briefing, the SEC seems to have finally backed off its position that ETH is a security, stating BTC and ETH are the "largest crypto assets in existence but [are] not at issue here."

Briefly Noted:

ETH Spot ETF Application on the Horizon: Financial giant BlackRock has registered a corporate entity "iShares Ethereum Trust" in Delaware, **hinting at the imminent submission** of a spot Ether ETF filing. Similar to the spot Bitcoin ETF filings, **ETH has been approved to be trading in futures products** but this would be the first offering of an ETH spot ETF. It will be interesting if the SEC resists this product, or if in the wake of the **Grayscale decision**, an approval is granted without needing judicial intervention.

President Releases Executive Order on AI: While not directly focused on digital assets, the Presidential Executive Order on Safe, Secure, and Trustworthy Artificial Intelligence did include some focus on digital assets, including listing strengthening "privacy-preserving research and technologies, such as

cryptographic tools...” as an area of emphasis. To read more on the Executive Order, check out the [Polsinelli client alert](#) on this subject.

SEC Notes Difficulty in Recruiting Talent Due to Crypto Divesting Requirements: The SEC [cannot find people to hire in crypto](#) because of an [Office of Inspector General](#) rule which says an individual [cannot own any crypto](#) at all if they participate in crypto enforcement actions. As aptly stated in an [article published by Paradigm Policy](#): you can't regulate what you don't understand.

DeFi Education Fund Issues Tax Proposal Comment Letter: The DeFi Education Fund issued its [tax proposal comment letter](#) which lists all the ways the proposed rules would have potentially unanticipated and disastrous consequences. With over 115,000 comments so far, the IRS has some work to do on these proposed rules.

SEC's Staff Accounting Bulletin No. 121 (“SAB 121”) Rejected by GAO: The Government Accountability Office (“GAO”) [rejected the SEC's attempt](#) at [rulemaking-without-rulemaking](#) by ruling that SAB 121, which required [custodied digital assets](#) be listed as liabilities on balance sheets, [failed to abide by the Congressional Review Act](#).

Conclusion:

The recent developments in the blockchain and crypto ecosystems illustrate a dynamic and evolving landscape at the intersection of technology, finance, and law. The guilty verdict in Sam Bankman-Fried's trial and the SEC's ongoing enforcement actions, including those against the founders of SafeMoon, underscore the legal complexities and regulatory challenges in the digital asset space. Meanwhile, traditional financial firms expanding their cryptocurrency-backed ETF

offerings and the Presidential Executive Order on AI recognizing the role of cryptographic proofs highlight the growing mainstream integration and significance of blockchain technology. These developments, along with others discussed, reflect a pivotal moment in the digital asset industry, balancing regulatory scrutiny with innovative expansion.

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