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Another Court Rules Virtual Currencies are Commodities Subject to CFTC Oversight

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"The definition of 'commodity' is broad. Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities." (*In re Coinflip, Inc*., CFTC No. 15-29 (Sept. 17, 2015)). This has been the view of the Commodity Futures Trading Commission (CFTC) since at least 2015, and the courts increasingly appear to be affirming the Commission's assertion of jurisdiction over the virtual currency market.

The U.S. District Court for the District of Massachusetts is the latest court to rule that virtual currencies are commodities, and subject to CFTC jurisdiction. (See *CFTC v. My Big Coin Pay, Inc*, 1:18-CV-10011-RWZ). In *My Big Coin*, the district court entered an order holding that the CFTC has the power to prosecute fraud involving virtual currency, even in instances where there is no futures contract over the relevant virtual currency.

A "commodity" as defined in the Commodities Exchange Act (CEA) includes a list of enumerated agricultural products, "and all other goods and articles… and all services, rights, and interests… in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C §1a(9).

The defendants argued that a commodity under this definition required the specific item at issue be the subject of a futures contract. The only existing futures are on Bitcoin (CME's BTC and CBOE's XBT), no other virtual currency currently underlies a futures contract. Because contracts for future delivery were not "dealt in" the virtual currency at issue, My Big Coin (MBC), defendants argued MBC could not be a commodity under the CEA. The court rejected the defendant's argument, holding that the "CEA only requires the existence of futures trading within a certain class… to be considered commodities."

This holding is consistent with an earlier decision in the Eastern District of New York, where the court found virtual currencies fell "well-within" the definition of commodity, and can therefore be regulated by the CFTC. (See *CFTC v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018)).

McDonnell is distinguishable from *My Big Coin*, in that *McDonnel* involved alleged fraud in connection with Bitcoin, a virtual currency with an existing futures market. This distinction was apparently not relevant to the court in *My Big Coin*. It ruled that if futures contracts exist within a certain class of commodities (such as virtual currency), then *all* items within that class are considered commodities under the CEA.

"[MBC] is a virtual currency and it is undisputed that there is futures trading in virtual currencies (specifically involving Bitcoin). That is sufficient…to allege that [MBC] is a 'commodity' under the Act." *(See My Big Coin,* 1:18-CV-10011-RWZ).

It is important to note the court also rejected Defendant's argument that the CFTC's anti-fraud authority under Section 6(c)(1) of the CEA extended only to fraudulent market manipulation, holding that the "broad language in the statute" "explicitly prohibit[s] fraud even in the absence of market manipulation."

Section 6(c) of the CEA, and the ancillary CFTC rule 180.1, prohibit the use of any manipulative or deceptive device or contrivance in connection with transactions involving commodities in interstate commerce. 17 C.F.R. §180(a)(1)-(3). The CFTC has looked to assert this authority not only over instances of fraud in the cash

commodity market that manipulates the derivatives market, but also in instances of fraud where no market manipulation, or even a relevant futures market, exists.

This finding again was consistent with the *McDonnell* court, which faced a similar argument. Not all courts who have decided this issue, however, are in agreement. In May this year a US District Court for the Central District of California found that "the CEA unambiguously forecloses the application of 6(c)(1) in the absence of actual or potential market manipulation. (*CFTC v Monex*, SACV 17-01868 JVS). This decision is being appealed by the CFTC.

The rulings in *My Big Coin* and *McDonnell* are particularly broad, and extend CFTC jurisdiction not only over all virtual currencies, but over all fraud in such virtual currencies, regardless of any impact or manipulation on a futures contract. The CFTC, however, is not the only regulator looking to assert or extend its enforcement rights over virtual currency market participants. There have been a series of recent enforcement actions announced by the CFTC, SEC and FINRA.

First, the SEC entered an order finding that Crypto Asset Management LP (CAM) offered a fund that operated as an unregistered investment company while falsely marketing it as the "first regulated crypto asset fund in the United States." According to the SEC's order, hedge fund CAM raised more than $3.6 million over a four-month period in late 2017 while falsely claiming that it was regulated by the SEC and had filed a registration statement with the agency. By engaging in an unregistered non-exempt public offering and investing more than 40 percent of the fund's assets in digital asset securities, CAM caused the fund to operate as an unregistered investment company.

Second, the SEC settled charges against another firm and its owners for violations of the Securities Exchange Act. Specifically, the Commission found a platform that brokered both secondary purchases of virtual currencies and sales of ICOs was improperly operating as an unregistered broker/dealer. This was the SEC's first case charging unregistered broker-dealers for selling digital tokens after the SEC issued The DAO Report in 2017 cautioning that those who offer and sell digital securities must comply with the federal securities laws.

Additionally, the SEC and CFTC filed charges in separate complaints against a virtual currency dealer based in the Marshall Islands and its Austrian based CEO for various federal regulatory violations, including: failure to properly register as a security-based swaps dealer, failure to properly register as a FCM, and failure to properly maintain adequate anti-money laundering procedures.

Finally, FINRA announced charges against an individual for selling virtual currency that was not properly registered as a security. These charges followed FINRA's recent request for member firms to voluntarily disclose their virtual currency activities (see previous remarks). FINRA asked firms to not only disclose their activity, but the outside virtual currency business activities of their associated persons.

The recent caselaw and regulatory actions continue the trend towards more regulatory oversight of the virtual currency market. While the *McDonnell* and *My Big Coin* holdings appear far-reaching, they (along with the enforcement actions of other regulators) have provided some clarity to the market participants.