To remain competitive, companies find themselves increasing their efforts to digitally transform their businesses by developing new offerings based on emerging technologies and integrating these technologies into existing product and service offerings.

This is our seventh monthly bulletin for 2020, aiming to help companies identify important and significant legal developments governing the use and acceptance of blockchain technology, smart contracts and digital assets.

While the use cases for blockchain technology are vast, from copyright protection to voting, most of the current adoption is in the financial services section and the focus of this bulletin will be primarily on the use of blockchain and or smart contracts in that sector. With respect to digital assets, we have organized our approach to this topic by discussing it in terms of traditional asset type or function (although the types and functions may overlap), that is, digital assets as:

- Securities
- Virtual currencies
- Commodities
Digital assets can themselves be assets or instead can reflect the ownership of an underlying asset. For example, electronic records that are the equivalents of negotiable instruments and electronic chattel paper would be digital assets, as would an electronic recording of a security interest in the underlying asset, such as recording title to real or personal property and the use of tokens to represent revenue streams from otherwise illiquid assets such as patents and commercial real estate (sometimes referred to as a “tokenized” or digitized asset).

In addition to reporting on the law and regulation governing blockchain, smart contracts and digital assets, this bulletin will discuss the legal developments supporting the infrastructure and ecosystems that enable the use and acceptance of these new technologies.

Each issue will feature in-depth insight on a timely and important current topic. In this issue, we review the decision of the New York appellate court regarding the New York attorney general’s investigative powers under the Martin Act.

**INSIGHT**

**Court upholds New York AG’s Martin Act authority to investigate virtual currency fraud**

By Scott R. Wilson, Peter Karanjia, Jessica Masella and Michael Fluhr

A recent decision by the state appellate court in Manhattan in the New York AG’s long-running investigation into the virtual currency “tether” reaffirms the strength and breadth of the office’s investigative powers under New York’s Martin Act. Read more.

**FEDERAL DEVELOPMENTS**

**Virtual currency**

- **OIG audit discloses failure of DEA controls involving virtual currencies.** On June 16, the Office of the Inspector General (OIG) released a report entitled “Audit of the Drug Enforcement Administration’s Income-Generating, Undercover Operations” assessing the controls regarding the DEAs undercover financial transactions conducted during 2015 through 2017 to infiltrate and dismantle drug trafficking and money laundering organizations (Attorney General Exempted Operations or AGEOs). The report concluded that the DEA did not appropriately mitigate AGEO risks because it did not consistently implement or follow effective controls, requirements and safeguards, and notably failed to “establish strict internal controls, risk mitigation techniques, and appropriate record keeping practices for AGEOs involving virtual currency.” The report recommends more structured procedures and increased oversight for virtual currency-related activities.

- **Federal Reserve Board publishes report on basket-backed stablecoins.** On June 22, the Federal Reserve Board (FRB) announced publication of a report entitled “Global Demand for Basket-Backed Stablecoins,” which are stablecoins backed by a “basket” of assets. Staff of the FRB found that demand for such a currency would be small, but may increase welfare if widely accepted. Additionally, the backing asset composition does not significantly affect welfare and there would be limited incentives to invest in the stablecoin.

- **IRS issued RFI for cryptocurrency tracing pilot.** On June 30, the Internal Revenue Service (IRS) published
a Request for Information (RFI) in connection with its Criminal Investigation Division Cyber Crimes Cryptocurrency Initiative. The RFI sought the following information for a pilot program that would allow developers and testers to more easily conduct investigative research and tracing of distributed ledger transactions involving privacy cryptocurrency coins. The deadline for response was July 14, with submissions to Marcela.a.almeida@irs.gov and pilotirsicyber@ci.irs.gov.

- **Senate Banking Committee held hearing on digitization of money and payments.** On June 30, the Senate Committee on Banking, Housing, and Urban Affairs (Committee) held a hearing entitled, “The Digitization of Money and Payments,” which included questions and testimony regarding a US central bank digital currency (CBDC). Hearing participants included J. Christopher Giancarlo, former Chair, CFTC. The Committee Chair, in his opening statement, said, “As I said in our last digital currency hearing, it seems to me that these and similar innovations are inevitable, beneficial, and the US should lead in their development.” Mr. Giancarlo asserted that Congress should urge the Treasury Department and the Federal Reserve to conduct CBDC pilot programs leveraging public-private partnerships.

- **CFTC guidance on delivery of digital assets now effective.** The US Commodity Futures Trading Commission (CFTC) final interpretive guidance concerning retail commodity transactions involving certain digital assets became effective on June 24. The guidance clarifies the CFTC’s views regarding the “actual delivery” exception to Section 2(c)(2)(D) of the Commodity Exchange Act (CEA) in the context of digital assets that serve as a medium of exchange, colloquially known as “virtual currencies.” For more information, see our April 2020 issue.

- **FTC issues cryptocurrency blackmail scam alert.** In a blog entry dated June 26, the FTC warns consumers against cryptocurrency blackmail scams. The scam setup described by the FTC is a consumer receiving an email with a threat that the sender has access to the consumer’s cell phone or computer, and the sender is about to make public the consumer’s sensitive videos, pictures, or compromising information. The sender is requesting a ransom payment using Bitcoin or another cryptocurrency to avoid the public release of the consumer’s sensitive information. The FTC is tracking an uptick in the number of reports of this scam. The FTC warns that the sender of such an email is likely a scammer and is asking consumers not to pay the ransom. According to the FTC, such ransom demands are using threats, intimidation and high-pressure tactics to trick consumers into paying money, and such emails are criminal extortion attempts and the FTC is urging consumers to report this type of scam to the FBI and to the FTC.

**Commodities**

- **CFTC issues strategic plan.** On July 8, the Commodity Futures Trading Commission (CFTC) announced finalization of its Strategic Plan 2020-2024, which includes as an objective of Strategic Goal 3 to “develop a holistic framework to promote responsible innovation in digital assets.”

**STATE DEVELOPMENTS**

**Virtual currency**

- **New York DFS publishes guidance on adoption or listing of virtual currencies.** On June 18, the New York Department of Financial Services (DFS) published its final guidance regarding how virtual currency businesses that are authorized by DFS may list new virtual currencies in addition to those approved in their initial DFS applications. The guidance adopts a framework enabling such businesses to self-certify the listing or adoption of new currencies without further approval from DFS in accordance with the businesses’ written coin-listing policy approved by DFS, and implements a DFS “greenlist” webpage listing all currencies permitted without DFS prior approval.

- **New York DFS publishes notice of BitLicense application procedures.** On June 18, the New York DFS published a notice announcing two practices regarding its review of BitLicense applications. The DFS will limit substantive review of applications to only those applications ready for such review, and will limit the review process to a maximum of three deficiency letters, with their cure periods, before denying such deficient applications. The DFS also updated its BitLicense FAQ page regarding these practices.

- **New York DFS issues request for comments on conditional BitLicense framework.** On June 18, the New York DFS announced a proposed conditional licensing framework which would allow a new entrant to work in collaboration with a holder of an authorized BitLicense or a New York limited purpose trust charter to initiate virtual currency business activity in New York under the conditional license while seeking to obtain their own BitLicense. The DFS seeks public comments regarding the proposed framework, which must be submitted by
August 10 to innovation@dfs.ny.gov.

- **NY DFS announces virtual currency program in partnership with SUNY.** On June 18, the NY DFS announced it signed a Memorandum of Understanding with the State University of New York (SUNY) to launch a virtual currency program, “SUNY Block.” Once licensed by DFS, SUNY Block will be able to support nascent virtual currency entities from local communities, including those started or run by students or alumni, through the proposed conditional licensing framework.

- **Federal Reserve Bank of NY asserts “Bitcoin is not a new type of money.”** On June 18, staff members of the New York Federal Reserve Bank (FRB) published an article, “Bitcoin Is Not a New Type of Money,” arguing that bitcoin is not a new type of money but instead is a new type of exchange mechanism for the transfer of money and other assets.

- **New Hampshire man sues IRS for unlawful seizure of private cryptocurrency data.** James Harper filed a lawsuit on July 15 against the Internal Revenue Service (IRS), James Harper v. IRS et al., civ. action no. 1:20-cv-00771 (DNH 2020), asserting that the IRS violated the Fourth and Fifth Amendments and statutory protections in obtaining Harper’s bitcoin transaction records from third party blockchain exchanges without any particularized suspicion that he had violated any law and without first providing him with notice and opportunity to challenge the seizure of his information. The complaint further alleges that Harper discovered the violation on August 9, 2019, when he received a letter from the IRS informing him that financial records relating to his ownership of bitcoin had been obtained by the IRS, which information the complaint alleges was obtained through a “John Doe” administrative summons served on a blockchain exchange.

- **BlockCrushr sues for misappropriation of trade secrets.** On July 14, BlockCrushr filed a complaint with the US District Court of the Eastern District of New York against ConsenSys, BlockCrushr, Inc. v. ConsenSys Inc., et al., case no. 1:20-cv-03134, alleging that ConsenSys, a BlockCrushr investor and mentor, misappropriated trade secrets related to BlockCrushr’s recurring payment systems enabled by smart contracts on the Ethereum blockchain, and launched an identical, competing product the day before BlockCrushr was scheduled to publicly launch its product. BlockCrushr had allegedly participated in the ConsenSys Tachyon accelerator program, accepted investment monies from ConsenSys and, as a condition of such investment, disclosed its confidential development information. The complaint alleges misappropriation and breach of contract and seeks treble, compensatory, punitive and exemplary damages, a constructive trust for disgorgement and a permanent injunction.

### INDUSTRY DEVELOPMENTS

**Virtual currency**

- **PCAOB issues guidance for audits of cryptoassets.** The Public Company Accounting Oversight Board (PCAOB) recently published guidance for auditors entitled “Audits Involving Cryptoassets – Information for Auditors and Audit Committees,” which focuses on the identification and assessment of the risks of material misstatement to the financial statements related to cryptoassets other than stablecoins, as well as the planning and performing of an appropriate audit response. The guidance highlights considerations for addressing certain responsibilities under PCAOB standards for auditors of issuers transacting in or holding cryptoassets, and suggests questions that audit committees may consider asking their auditors when transactions involving cryptoassets or holdings of cryptoassets are material to the issuer’s financial statements.

### ENFORCEMENT ACTIONS

**FEDERAL**

**Securities**

- **SEC settles Telegram case.** On June 26, the Securities and Exchange Commission (SEC) announced that it obtained a final judgment approving SEC settlements with Telegram Group Inc. and its wholly owned subsidiary TON Issuer Inc. (collectively, “Telegram”). The judgment resolves the SEC’s allegations that Telegram’s offering of “Gram” digital tokens violated the federal securities laws. Telegram is liable for disgorgement of more than $1.2 million and a civil penalty of more than $18.5 million. The judgment also enjoins Telegram from future violations of the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933 and requires
On June 25, the SEC filed for court approval of its settlement with two entities, California-based Abra and Philippines-based Plutus Technologies. On July 9, the US Attorney’s Office for the District of New Jersey announced that it filed an emergency action and obtained a temporary restraining order and asset freeze against two Pennsylvania-based brothers and three entities they control to stop an offering fraud and the misappropriation of investor proceeds. According to the SEC’s complaint, from at least July 2019 through May 2020, Sean Hvizdzak and Shane Hvizdzak offered securities in a private fund that purported to invest in digital assets by misrepresenting fund performance, fabricating financial statements and forging audit documents. In addition, the SEC alleges that the Hvizdzak brothers diverted tens of millions of dollars from the fund to personal accounts at banks and digital asset trading platforms. On June 16, in addition to granting a temporary restraining order and an asset freeze, the US District Court for the Western District of Pennsylvania ordered an accounting, expedited discovery, and an order prohibiting the destruction of documents. A hearing is scheduled for June 30, to consider continuing the asset freeze and the issuance of a preliminary injunction.

- **SEC emergency action halts cryptocurrency offering.** On June 19, the SEC announced that it filed an emergency action and obtained a temporary restraining order and asset freeze against two Pennsylvania-based brothers and three entities they control to stop an offering fraud and the misappropriation of investor proceeds.
- **SEC obtains judgment against former CEO of Shopin.** On June 23, the SEC announced that the US District Court for the Southern District of New York entered a final judgment on June 29 against Eran Eyal, the founder and former chief executive officer of UnitedData, Inc. d/b/a/ Shopin, for conducting an allegedly fraudulent initial coin offering (ICO). (For information on the SEC’s complaint, see our January 2020 issue.) Without admitting or denying the allegations of the SEC’s complaint, Eyal consented to the entry of the order, which enjoins him from future violations of the registration provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, bars him from acting as an officer or director of a public company and enjoins him from engaging in any offering of digital asset securities. The judgment also orders Eyal to disgorge $422,100 in gains plus $34,940 in prejudgment interest, which is deemed satisfied by Eyal’s payment of approximately 3,105.78 Ether tokens pursuant to a prior plea agreement in a New York State criminal action. The SEC voluntarily dismissed its claim against Shopin.
- **SEC seeks approval of Dropil settlement.** On June 25, the SEC filed for court approval of its settlement with Dropil Inc. and its co-founder and COO Patrick O’Hara, resolving allegations of its complaint filed in April (for more information on the complaint, see our May 2020 issue). The settlement requires payment of disgorgement and a civil penalty and will permanently bar O’Hara from selling cryptocurrency in the future and from committing any future violations of the Securities Act of 1933 and the Securities Exchange Act of 1934.
- **SEC charges app developer for unregistered blockchain security-based swap transactions.** On July 13, the SEC announced that it charged two entities, California-based Abra and Philippines-based Plutus Technologies Philippines Corp, for offering and selling security-based swaps to retail investors without registration and for failing to transact those swaps on a registered national exchange. According to the SEC’s order, Abra developed and owns an app that enabled users to enter into contracts that provide synthetic exposure to price movements of stocks and exchange-traded fund (ETF) shares trading in the US through blockchain-based financial transactions with Abra or with Plutus Technologies. The SEC found that Abra told users they could choose securities whose performance they wanted to mirror, and the value of their contract would vary by the same amount as the price of the underlying security. The SEC further found that these contracts were security-based swaps subject to US securities laws. Without admitting or denying the findings in the order, Abra and Plutus Technologies agreed to a cease-and-desist order and to pay a combined penalty of $150,000. In a parallel action, the CFTC announced a settlement with Abra and Plutus Technologies arising from similar conduct.

**STATE**

**Virtual currency**

- **Co-founder of Centra Tech pleads guilty in ICO fraud scheme.** On June 16, the US Attorney’s Office for the Southern District of New York announced that Robert Joseph Farkas, a co-founder of Centra Tech Inc., pled guilty to conspiring to commit securities and wire fraud in connection with a scheme to induce investment of more than $25 million to purchase digital tokens issued by Centra Tech through an initial coin offering in 2017. Farkas is facing up to seven years in prison.
- **Romanian programmer admits conspiracy scheme in creation of BitClub Network.** On July 9, the US Attorney’s Office of the District of New Jersey announced that Silviu Catalin Balaci, a Romanian citizen, admitted to conspiring to engage in wire fraud and offering and selling unregistered securities in connection with his role in the BitClub Network, a cryptocurrency mining scheme worth at least $722 million. Balaci and four co-defendants were charged previously by indictment in December 2019 in connection with the scheme. For
more information on the co-defendants, please see our January 2020 issue. In connection with his plea, Balaci confirmed that during the course of the scheme, the BitClub Network took at least $722 million worth of bitcoin from investors. Balaci faces a maximum penalty of five years in prison and a fine of $250,000, or twice the pecuniary gain to the defendant or loss to the victims. A sentencing date has not been set.

- **US Court of Appeals finds blockchain transactions not subject to claims of privacy.** On June 30, the US Court of Appeals for the Fifth Circuit affirmed the decision of the US District Court for the Western District of Texas, which denied Richard Gratkowski’s motion to suppress evidence collected from the publicly available Bitcoin blockchain and by subpoena from Coinbase, the holder of Gratkowski’s bitcoin account. Gratkowski moved to suppress the evidence obtained through a warrant to search his residence, asserting that the subpoena to Coinbase and the blockchain analysis violated his Fourth Amendment rights, specifically that Gratkowski had a reasonable expectation of privacy to his bitcoin transactions and Coinbase records. The court found that Gratkowski did not have a reasonable expectation of privacy because the transaction information on the Bitcoin blockchain is publicly available. It further found that Gratkowski did not have a reasonable expectation of privacy regarding the Coinbase records of his Bitcoin account, finding the Coinbase records “akin to bank records,” which are not protected by the Fourth Amendment.

- **Texas securities regulator issues cease and desist orders.** On July 7 and 8, the Texas State Securities Board (TSSB) issued Emergency Cease and Desist Orders against the following:
  - Mirror Trading International Pty Ltd, a South African company, its founder and CEO Cornelius Johannes “Johann” Steynberg and three others, for perpetrating an international multilevel marketing scheme tied to investments in a cryptocurrency and forex trading pool and illegally soliciting Texas investors without required registration. Investors were told their bitcoin investments would be pooled, then be traded on the forex market through the use of artificial intelligence technology that would generate them profits of 10% monthly on deposits as low as $100.
  - Loudmines and Rose Davis, and Swiftminex and Elizabeth Rossielo, each for fraudulent claims relating to a scheme to serve as international cryptocurrency trading platform, trading bitcoin and mining cryptocurrency.

### SPOTLIGHT ON INTERNATIONAL DEVELOPMENTS

**Virtual currency**

- **BIS publishes chapter on CBDCs and payments.** On June 24, the Bank for International Settlements (BIS) published a chapter in its Annual Economic Report 2020 entitled, “Central Banks and Payments in the Digital Era.” The key takeaways identified in the chapter include that central banks play a pivotal role in maintaining the safety and integrity of the payment system, that central banks are embracing digital innovation in payment services, and that CBDCs can foster competition among private sector intermediaries and set high standards for safety and risk management.

- **BIS announces expansion of innovation hub.** On June 30, the BIS announced it will expand its Innovation Hub to new locations in Toronto, London, Frankfurt, Paris and Stockholm, in collaboration with local member central banks. The BIS will also form a strategic partnership with the Federal Reserve System location in New York.

- **Belarus Central Bank approves pilot program for bank ICOs.** On Wednesday, June 10, the Belarus National Bank reportedly approved 12 commercial banks to test issuing digital tokens in initial coin offerings (ICOs) as part of a pilot program within the country’s blockchain free trade zone. The pilot will last from January 1, 2021 – January 1, 2024.

- **National Bank of Cambodia publishes report on blockchain-based payments system.** On June 18, the National Bank of Cambodia (NBC) published a report entitled, “Project Bakong – Next Generation Payment System,” which provides an overview of the Project, key observations and findings, and possible implications. The Project included development of use cases and prototype tests of blockchain and distributed ledger technology in the national payment system. The Bank is conducting a pilot test of the project to identify potential issues with the Project before an official launch.

- **Staff of Bank of Canada publish report on CBDC design considerations.** On June 29, staff of the Bank of Canada published a report entitled, “Designing a CBDC for Universal Access,” that discusses how a CBDC could be designed for universal access, if adopted by the Bank. The report asserts that a Canadian CBDC should be as accessible as cash, available in multiple formats and used through a dedicated universal access device.
• **ECON publishes recommendations on digital finance.** On June 4, the European Parliament’s Committee on Economic and Monetary Affairs (ECON) published a draft report describing its recommendations to the European Commission on Digital Finance regarding emerging risks in cryptoassets and regulatory and supervisory challenges in the area of financial services, institutions and markets. The draft report proposes a motion for a European Parliament resolution that would adopt measures at the European level to consolidate and expand the digital finance sector across the European Union, providing European financial entities and fintechs with a comprehensive and stable regulatory framework to expand their activities and operate with legal certainty.

• **FATF publishes review of adoption of FATF standards on virtual assets.** On July 7, the Financial Action Task Force (FATF) announced the publication of “12 Month Review of Revised FATF Standards – Virtual Assets and VASPs,” a review of the implementation of the FATF revised standards on virtual assets and virtual asset service providers. The report finds that, overall, both the public and private sectors have made progress in implementing the revised FATF standards and concluded there was no need to revise the FATF standards.

• **FATF publishes report on stablecoins.** On July 7, the FAFT announced the publication of “FATF Report to the G20 Finance Ministers and Central Bank Governors on So-called Stablecoins.” The report finds that stablecoins have the potential for mass adoption, making them attractive to criminals and terrorists to launder their proceeds of crime and finance their terrorist activities. The report discusses how the FATF plans to enhance the global anti-money laundering and counter-terrorism financing framework for virtual assets and so-called stablecoins, and complements the findings of the FATF’s 12 Month Review.

• **Bank of Japan publishes report on implanting a CBDC.** On July 2, the Bank of Japan reportedly published a report entitled, “Technical Challenges of CBDC: Central Bank Digital Currency As the Cash Equivalent,” in which the Bank considers the pros and cons of creating a digital version of the Japanese Yen.

• **Mauritius Financial Services Commission issues guidance on security token trading systems.** The Financial Services Commission (FSC) of Mauritius, an island-state off the coast of Madagascar, on June 15 announced the issuance of Guidance Notes on the Security Token Trading Systems under Section 7(1)(a) of the Mauritius Financial Services Act 2007. The Guidance Notes provide a framework for the implementation of standards for security token offerings. The Guidance Notes enable security token trading systems to become eligible for a FSC license.

• **Singapore man fined for promoting multi-level marketing scheme linked to OneCoin.** Reportedly, on July 1 Fok Fook Seng, 52, was fined $100,000 Singapore dollars (nearly US$72,000) for promoting OneCoin in violation of the Singapore Multi-Level Marketing and Pyramid Selling (Prohibition) Act. Fok used a Facebook page to advertise the scheme between January 2016 and June 2017. Those convicted under Singapore’s law face fines of up to $200,000 Singapore dollars (US$143,340) and/or five years in prison. See our April 2020 issue for additional information on OneCoin and indictments in the US.

For more information

Please visit our Coronavirus Resource Center and subscribe to our mailing list to receive alerts, webinar invitations and other publications to help you navigate this challenging time.

**Trending**

Coronavirus: US federal and state governments work quickly to enable remote online notarization to meet global crisis

OCIE announces 2020 examination priorities

**More from DLA Piper**

Fifth Money Laundering Directive - Summary of changes to UK AML law

In case you missed it
Legal Developments in Categorising and Tracing Cryptoassets – DLA FinBrief blog

Our analysis of the July 31 FCA policy statement PS19/22: Guidance on Cryptoassets, which sets out the FCA's final guidance on whether dealings involving cryptoassets require authorisation under FSMA.

Read these next

The latest issue of *eSignature and ePayment News and Trends*

The latest issue of our bulletin *Bank Regulatory News and Trends*

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