



# Blockchain and Digital Assets News and Trends

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## BLOCKCHAIN AND DIGITAL ASSETS NEWS AND TRENDS

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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 eighth monthly bulletin, 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

- Deposits, accounts, intangibles
- Negotiable instruments
- Electronic chattel paper
- Digitized assets

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 also report on the legal developments to support the infrastructure and ecosystems enabling 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 look at *Liu v. SEC*, which has the potential to upend years of case law on the SEC's ability to obtain disgorgement as an equitable remedy.

For related information regarding digital transformation, please see our monthly bulletin, *eSignature and ePayment News and Trends*.

## INSIGHT

### The other shoe drops: Supreme Court will decide whether the SEC may obtain disgorgement as an equitable remedy

By Deborah R. Meshulam, Christine Elizabeth Bass, Eric Christofferson and Jason S. Lewis

The US Supreme Court has decided to take up *Liu v. SEC*, a case asking whether the SEC is entitled to seek and obtain disgorgement as equitable relief. The Supreme Court's ultimate decision on this issue has the potential to upend decades of authority. Read more.

#### FEDERAL DEVELOPMENTS

##### *Digital assets*

**SEC enforcement division publishes fiscal year 2019 Annual Report.** On November 6, the SEC's Enforcement Division issued its Annual Report for fiscal year 2019, detailing the Division's efforts and initiatives in a number of areas. One of the areas of significant focus is cyber-related misconduct, including cases involving ICOs and digital assets, and violations of SEC rules designed to monitor security and capabilities of the US securities markets' technological infrastructure. The report also highlights the SEC's use of complex analytic tools and capabilities to analyze large amounts of data, including trading data and communications metadata, to bring important cases that may not have been possible without that ability.

##### *Securities*

**Legislation introduced classifying stablecoins as securities.** On October 22, House Representative Sylvia Garcia (D-TX) published a draft bill, the Stablecoins are Securities Act of 2019 which would define managed stablecoins as securities under the Securities Act of 1933, Exchange Act of 1934, Investment Company Act of 1940, and Investment Advisers Act of 1940. If signed into law, the bill would give the SEC jurisdictional authority over all stablecoins and their issuers.

##### *Blockchain*

**Treasury Department announces blockchain project.** The Bureau of the Fiscal Service of the Treasury Department announced on October 17 that the Office of Financial Innovation and Transformation (FIT) is partnering with the Bureau's Payment Management division and the National Science Foundation on a blockchain project proof

of concept which tokenizes (digitally represents) and transfers payment authorizations within a simulated letter of credit system. This proof of concept will be the first time FIT will apply blockchain technology to a financial use case.

### ***Virtual currency***

**IRS amends 1040 form to address virtual currency.** On October 12, the IRS proposed a draft amended Schedule 1 to Form 1040, which includes a question asking the taxpayer, "At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?" The IRS Chief Counsel reportedly stated that the agency's main concern is lack of reporting of cryptocurrency transactions.

**FATF clarifies stablecoin guidance.** On October 18, the Treasury Department announced that the Financial Action Task Force (FATF) concluded its 31st plenary meeting with a public statement that clarified guidance on stablecoins and adopted changes regarding virtual assets, among other reports related to anti-money laundering/countering the financing of terrorism (AML/CFT).

### ***Commodities***

**LabCFTC to become agency of CFTC.** CFTC Chairman Heath Tarbert announced on October 24 at the CFTC's second annual Fintech Forward Conference that LabCFTC, the CFTC fintech initiative dedicated to coordinating with fintech innovators, will become an independent operating office of the agency. LabCFTC was established in 2017 under the Office of General Counsel and, now reporting directly to the Chairman, will continue its mission of acting as the agency's research wing into new financial technology, including cryptocurrency and blockchain applications.

### ***FinTech***

**US financial regulators join the Global Financial Innovation Network.** On October 24, the SEC, CFTC, OCC and FDIC issued a joint press release announcing that they have signed onto the Global Financial Innovation Network (GFIN). The GFIN is an international alliance of government regulators which was formally launched in January 2019 to create a "global sandbox" for financial innovation.

**FinTech regulatory sandbox bill introduced.** House Representative Patrick McHenry (R-NC), the ranking Republican of the House Financial Services Committee, reintroduced on October 21 the Financial Services Innovation Act, HR4767 (formerly HR6118). The bill, if enacted, would establish a Financial Services Innovation Office (FSIO) within each governmental financial agency – the Federal Reserve, the CFPB, the CFTC, the Treasury, the FDIC, the Federal Housing Finance Agency, the FTC, the National Credit Union Administration Board, the OCC, and the SEC. The FSIO in each agency would promote and support the development of financial innovations and coordinate with the other FSIOs.

## **STATE DEVELOPMENTS**

### ***Virtual currency***

**CSBS solicits comments on draft model act for MSBs.** On October 10, the Conference of State Bank Supervisors (CSBS) announced it is soliciting public input on draft language for model payments legislation that amends the Uniform Law Commission's Money Services Act to streamline multistate licensing and supervision for nonbank money services businesses (MSBs). The proposed model payments legislation creates standards in accordance with recommendations of the CSBS Fintech Industry Advisory Panel, part of CSBS Vision 2020.

### ***FinTech***

**NY DFS joins Global Financial Innovation Network.** On October 25, the New York Department of Financial Services announced it has joined the GFIN. The NY DFS joins the office of the Arizona Attorney General, as well as the SEC, CFTC, FDIC, and OCC, which joined the GFIN on October 24.

**NY District Court final judgment sets aside OCC's fintech charter.** On October 21, the US District Court for the Southern District of New York entered a final judgment in *Lacowell v. Office of the Comptroller of the Currency*, setting aside the OCC's regulation 5 C.F.R. § 5.20(e)(1)(i) "with respect to all fintech applicants seeking a national

bank charter that do not accept deposits." The judgment enables the OCC to pursue an appeal to the Court of Appeals.

### ***Blockchain***

**Utah expands blockchain voting project.** On October 21, Utah County, Utah reportedly announced the expansion of its blockchain voting project to allow disabled voters to use their smartphones to cast their ballots in the November municipal elections. The expansion came after the National Cybersecurity Center successfully completed a third-party audit of the county's August mobile voting pilot – showing that votes cast over the blockchain were recorded and tabulated accurately.

### ***INDUSTRY DEVELOPMENTS***

**G7 issues report on stablecoins.** In October 2019, the G7 Working Group on Stablecoins issued a report titled "Investigating the impact of global stablecoins." The report highlighted that stablecoins – which seek to stabilize the price of the "coin" by linking its value to that of a pool of assets – have the capability to address existing challenges in the payment system. However, stablecoins present numerous regulatory and oversight risks related to legal certainty; money laundering; the safety, security, and efficiency of the payment system; cybersecurity and operational resilience; data privacy; and consumer protection. Additionally, because the stablecoins are considered "global," they present additional challenges to countries' monetary policies and the international monetary system.

**Coindesk publishes crypto derivatives whitepaper.** This past month, Coindesk released a white paper which reviews (i) the investor benefits of crypto derivatives, such as addressing the issues of custody, investability and volatility; (ii) how crypto asset derivatives differ from derivatives of other assets; and (iii) the derivative products and markets available today.

**Blockchain platform receives broker-dealer and transfer agent licenses.** On October 21, security token startup Harbor Platform Inc. (Harbor) announced that its subsidiary, Harbor Digital Transfer Agent, LLC, has been granted a transfer agent registration from the SEC – one month after another Harbor subsidiary, Portum Capital, LLC, was issued a broker-dealer license. Harbor becomes the first blockchain company to receive both licenses, enabling the platform to provide full digital securities services to investors, issuers and placement agents, including Regulation A fundraising and due diligence.

## **ENFORCEMENT ACTIONS**

### ***FEDERAL***

#### ***Securities***

**Telegram responds to SEC complaint.** Telegram Group Inc. and its wholly-owned subsidiary TON Issuer Inc. (collectively, Telegram) filed an answer to the SEC's complaint asserting that the anticipated distribution of the "Gram" digital asset violated the registration requirements of the Securities Act of 1933. (See our October issue, reporting the compliant filing). Telegram's answer includes the following key defense themes:

- Telegram is a legitimate company that engaged in a legitimate private offering which was exempt from the registration requirements
- Telegram engaged with the SEC in an effort to make certain they complied with US securities laws
- SEC staff did not provide meaningful guidance as to whether the plans of Telegram would violate US securities laws and
- Telegram was not afforded due process because they did not receive fair notice of potential Securities Act violations.

The answer also details in two pages Telegram's interactions with the SEC over an 18-month period. Telegram also asserts that the SEC has no jurisdiction over the foreign purchasers, and that Telegram is not subject to the general or specific jurisdiction of the court. The preliminary injunction hearing is currently scheduled for February 2020.

#### ***Virtual currency***

**SEC and CFTC charge XBT Corp. with selling unregistered swaps for bitcoin.** In simultaneous press releases, the SEC and the CFTC each announced they have filed charges against XBT Corp. SARL, dba First Global Credit, for offering and selling unregistered security-based swaps to US investors using bitcoins, for failing to transact its swaps on a registered national exchange, and for failing to register as a futures commission merchant (FCM). The US regulators alleged that XBT conducted more than 18,000 security-based swaps between 2014 and 2019, consisting of more than \$100 million in transactions based on U.S.-listed securities. Without admitting or denying the findings, XBT consented to the SEC's cease-and-desist order and agreed to pay disgorgement of \$31,687 and a penalty of \$100,000. The CFTC's cease-and-desist order requires XBT to pay a \$100,000 civil monetary penalty and disgorgement.

**SEC obtains \$9.4 million settlement with Veritaseum.** On November 1, U.S. District Court for the Eastern District of New York entered a consent judgment settling the SEC's fraud allegations against Veritaseum Inc. and Veritaseum LLC, and their owner, Reginald Middleton, regarding the issuance of VERI tokens. The defendants will pay a total of \$9.4 million in civil monetary penalties and disgorgement. The original complaint was reported in our September issue.

### ***Distributed ledger***

**SEC issues No-Action letter to trust company for settlement service trial.** The SEC Division of Trading and Markets issued on October 28 a No Action letter to Paxos Trust Company, allowing Paxos to conduct a two-year trial of its securities settlement system service without registering as a clearing agency. The trial must be conducted within certain parameters: 1) only 7 participants may use the service; 2) only publicly traded equity securities are eligible; 3) the eligible securities must satisfy eligibility criteria; 4) volume limits apply to share volume; 5) compliance measures must be implemented; 6) Paxos must report and notify the SEC staff of certain events; and 7) the trial must wind down in its 23rd month.

### ***Commodities***

**CFTC obtains asset freeze against virtual currency options fraud scheme.** On October 16, the CFTC announced it has charged David Gilbert Saffron and Circle Society, Corp., with fraudulent solicitation, misappropriation, and registration violations, alleging that defendants fraudulently solicited more than \$11 million in bitcoin and US dollars to trade off-exchange binary options on foreign currencies and cryptocurrency pairs. The defendants allegedly guaranteed returns up to 300 percent, but misappropriated the funds. The CFTC obtained an asset freeze and is seeking restitution, disgorgement, injunction, civil money penalties, and registration and trading bans.

**CFTC obtains \$4.6 million default judgment against fraudsters using virtual currency to conceal illegal off-exchange swaps.** On November 1, the CFTC announced that the US District Court for the Eastern District of New York entered a final judgment by default in October 23 against Blake Harrison Kantor aka Bill Gordon, Nathan Mullins, Blue Bit Banc and Blue Bit Analytics, Ltd. ("Blue Bit") and others related to the solicitation of potential customers to purchase illegal off-exchange binary options via Blue Bit. The defendants sought to cover up their misappropriation by inviting customers to transfer their binary options account balances into a virtual currency known as ATM Coin. Kantor was previously convicted of conspiracy to commit wire fraud and other offenses based on the fraudulent scheme in a related criminal case in the US District Court for the Eastern District of New York. The judgment includes a permanent injunction, restitution of \$846,405.58, disgorgement of more than \$1 million, and a civil monetary penalty of \$2.8 million.

## **STATE**

### ***Virtual currency***

**Payment processor indicted for fraud and conspiracy.** On October 23, Oz Yosef, Crypto Capital principal, was reportedly indicted on three criminal counts by the US Attorney's Office of the Southern District of New York – conspiracy to operate an unlicensed money transmitting business, conspiracy to commit bank fraud, and bank fraud. Crypto Capital was a payment processor employed by token trading platform Bitfinex, and Yosef was arrested after authorities investigated Crypto Capital and discovered \$880 million had been misappropriated from Bitfinex.

**Texas sends cease and desist orders to fraudulent cryptocurrency companies.** On October 14, the Texas State Securities Board sent emergency cease and desist orders to Crypto Miner Limited aka Cyp Miner and PK Crypto Investment, and each of their executives Elizabeth Frazier, and Peggy Kay Brendan and Janet Osborn, respectively, for fraudulent statements made in the solicitation of unregistered cryptocurrency investments, without registration as broker-dealers. The orders allege the companies misrepresented their status as registered businesses and promised guaranteed, unrealistic returns.

**President of World Sports Alliance indicted for wire fraud.** On November 6, the US Immigration and Customs Enforcement's Homeland Security Investigations Office and the US Attorney for the Southern District of New York announced charges against Asa Saint Clair for defrauding investors and falsely promising guaranteed returns and an ownership interest in a digital coin offering known as IGOBIT. Saint Clair allegedly participated in a scheme tied to the launch of IGOBIT by World Sports Alliance, a purported intergovernmental organization. Saint Clair pled not guilty to the charges on November 13.

**New York announces plea deal on bitcoin money laundering operation.** The US Attorney for the Southern District of New York announced on November 6 that Hugh Brian Haney pled guilty to money laundering the proceeds of Haney's narcotics trafficking operations conducted on the dark web site Silk Road. The plea admitted to laundering more than \$19 million in profits through Bitcoin and other cryptocurrency.

## Recent Publications

M. Tank and D. Whitaker, *Law of Electronic Signatures, 2019 Edition*

### Trending

Hong Kong introduces strict conditions on cloud data storage

### More from DLA Piper

DLA Piper is pleased to announce the release of a special report, "Cryptocurrency and its impact on insolvency and restructuring," prepared on behalf of INSOL International. Among its findings: the rise in the use of cryptocurrencies has begun to create difficulties for the administration of bankruptcy cases.

### In case you missed it

DoD's new cybersecurity compliance program – what you need to know

### Read these next

Effective January 1, 2020, a game-changing privacy law will go into effect in California, the California Consumer Privacy Act of 2018. The CCPA will have profound implications for businesses that collect personal information about persons in California, even if the business is not based in the state. Find out more on our CCPA focus page.

In the latest issue of our monthly bulletin eSignature and ePayment News and Trends we discuss testing and protecting key data processing systems and we review the latest developments from the regulators, the legislatures and the courts.

DLA Piper discusses tokenization in real estate in the latest installment of our new series, *PropTech in the United States – where we're heading*.

DLA Piper has released an 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.

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