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 inaugural 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 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
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 take a look at the US Securities and Exchange Commission's Strategic Hub for Innovation and Financial Technology Framework for 'Investment Contract' Analysis of Digital Assets and the SEC Division of Corporation Finance's first "No Action" letter to a startup planning to sell digital assets.

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

INSIGHT

Unpacking the SEC's Digital Guidance Framework and No Action Letter

by Deborah Meshulam and Benjamin Klein

On April 3, the US Securities and Exchange Commission's (SEC) Strategic Hub for Innovation and Financial Technology (FinHub) published its "Framework for 'Investment Contract' Analysis of Digital Assets." The same day, the SEC's Division of Corporation Finance also issued its first "No Action" letter to a startup planning to sell digital assets.

The Framework describes the factors used by SEC Staff for assessing whether digital assets are "investment contracts" subject to federal securities laws; the No Action letter applies those factors. The Framework suggests that, over time, digital assets may evolve to a point where they are no longer securities.

While neither exhaustive nor binding, the Framework consolidates and expands upon principles previously articulated in SEC enforcement actions, press releases, and speeches. It offers industry participants insights on the types of activities that can expose them to US federal securities regulation.

A careful reading of the Framework, however, suggests that the SEC's staff continues to view offer, sale, and distribution of most digital assets – especially those in early stages where purchaser funds are used to develop and launch the asset and its platform – as securities.

Find out more.

FEDERAL DEVELOPMENTS

Securities

- **SEC extends review period for bitcoin exchange traded fund products.** On April 4, 2019, the SEC extended the period to act on the applications of the NYSE Arca, Inc. and the Cboe BZX Exchange, Inc. to propose rules and offer bitcoin ETF products.
- **SEC solicits feedback regarding application of its Custody Rule to digital assets.** On March 12, 2019, the SEC solicited feedback regarding its Custody Rule, business practices for investment advisers having "custody of client securities, as it applies to digital assets. Interested parties may submit their views to IMOCC@sec.gov.
- **SEC Chair agrees digital tokens can evolve to no longer represent investment contracts.** SEC Chair Jay Clayton sent a letter response to Congressman Ted Budd (R-NC) and others in which he agrees with Director of Corporation
Finance Bill Hinman’s statements in his speech, Digital Asset Transactions: When Howey Met Gary (Plastic), that digital asset transactions may change over time to no longer represent an investment contract under the Howey test. Although this letter does not constitute binding agency guidance, it suggest the eventual position the agency may take.

- OFAC updates FAQ to treat cryptocurrencies the same as fiat currencies. In a March 19, 2019 update to its FAQ, the US Treasury Department Office of Foreign Assets Control noted that it will treat cryptocurrencies the same as fiat currencies with respect to Specially Designated Nationals, including a field on the SDN list for digital currency addresses.

- NASAA advises Congress to be wary of regulatory sandboxes. The North American Securities Administrators Association (NASAA) has cautioned Congress to carefully evaluate proposed legislation designed to promote innovation, in order to avoid preemption of state laws that provide investor protections such as regulatory sandbox proposals; NASAA also recommended that Congress should require the SEC to provide guidance about the treatment of virtual currency and initial coin offerings under federal securities laws.

STATE DEVELOPMENTS

Blockchain

- Wyoming law authorizes blockchain filing system for commercial filings. On February 26, 2019, the governor of Wyoming signed into law HB0070, authorizing the Secretary of State, not later than December 31, 2021, to develop and implement a blockchain-based filing system for business entity and commercial filings otherwise required by law to be filed with the Secretary of State, including business entity formations and annual reports, as well as Uniform Commercial Code financing statements.

- South Dakota revises its UETA to address blockchain technology. On March 7, 2019, the governor of South Dakota signed into law HB1196, providing a definition of blockchain technology for certain purposes. The bill amends South Dakota’s Uniform Electronic Transactions Act (UETA) to add the following definition for blockchain technology: technology that uses a distributed, shared and replicated ledger, either public or private, with or without permission, or driven with or without tokenized crypto economics where the data on the ledger is protected with cryptography and is immutable and auditable. The bill further revises South Dakota’s UETA to state that both an electronic record and an electronic signature include a record or signature respectively that is secured by blockchain technology.

- Kentucky House adopts resolution urging study of blockchain technology. On March 14, 2019, the Kentucky House of Representatives adopted a resolution (HR 171) which urges the Kentucky Cabinet for Economic Development to work with state and federal officials to study the issue of blockchain technology to determine the best way to both support further innovation and economic growth and ensure that consumer privacy and rights are protected through enhanced cybersecurity.

- North Dakota authorizes distributed ledger pilot program. On March 21, 2019, the governor of North Dakota signed into law HB 1048, authorizing a distributed ledger pilot program. The bill allows the North Dakota Information Technology Department to select a state agency, upon the request of the state agency, to serve as a pilot program for the implementation and use of distributed ledger enabled platform technologies.

- Arkansas revises its UETA to address blockchain technology and smart contracts: On April 17, 2019, Arkansas adopted a bill (HB 1944) that revised its Uniform Electronic Transactions Act to address blockchain technology and smart contracts. Specifically, the new law states that a contract that contains a smart contract term and relates to a transaction shall not be denied legal effect, validity, or enforceability.

Banking

- Wyoming creates new form of bank to assist blockchain companies. On February 26, 2019, the governor of Wyoming signed into law HB74, creating “special purpose depository institutions” as a new form of bank to assist blockchain innovators in accessing secure and reliable banking services. In passing this bill, the Wyoming legislature found that many financial institutions both in Wyoming and across the US refuse to provide banking services to blockchain innovators and refuse to accept deposits that resulted from selling virtual currency or other digital assets.

- Utah aims to create regulatory sandbox. On March 22, 2019, the Utah Senate sent to the governor HB 378, which would create a regulatory sandbox program in the Utah Department of Commerce allowing participants to temporarily test innovative financial products or services on a limited basis without needing a license or otherwise being authorized to act under Utah’s laws. The bill describes who may participate, how the Department of Commerce will administer the program and what the reporting requirements for participants will be.

Digital Assets
• **Wyoming classifies digital assets under its UCC.** On February 26, 2019, the governor of Wyoming signed into law SF0125, establishing the legal classification of certain digital assets within Articles 8 and 9 of the Uniform Commercial Code, identifying three classes of digital assets and classifying these assets, solely for purposes of Uniform Commercial Code (UCC) Articles 8 and 9, as follows:

  - Digital consumer assets (UCC Article 9: general intangibles)
  - Digital securities (UCC Articles 8 and 9: securities and investment property) and
  - Virtual currency (UCC Article 9: money).

Each of the three classes is defined; also, the three classes do not, taken together, cover or address all digital assets.

Among other changes, the new law specifies a method for perfecting a security interest under UCC Article 9 based on control relating to digital assets and it authorizes banks to voluntarily provide custodial services for digital assets, consistent with the Securities and Exchange Commission's qualified custodian requirements.

• **Wyoming authorizes business entities to issue electronic certificate tokens.** On February 26, 2019, the governor of Wyoming signed into law HB185, authorizing a business entity, such as a corporation or limited liability company, to issue stock certificates in the form of electronic certificate tokens. The bill defines a "certificate token" as an electronic representation of a share of stock which contains certain information required under existing law for stock certificates (eg, the name of the stock recipient and the number and type of shares) and which is entered into a blockchain or other secure, auditable database.

**Securities**

• **Colorado enacts law providing certain exemptions to securities law for cryptocurrencies.** On March 6, 2019, the governor of Colorado signed into law SB19-023, providing limited exemptions from the securities laws for cryptocurrencies and enacting the Colorado Digital Token Act. The bill provides limited exemptions from the securities registration and securities broker-dealer and salesperson licensing requirements for persons dealing in digital tokens. "Digital token" is defined as a digital unit with specified characteristics, secured through a decentralized ledger or database, exchangeable for goods or services and capable of being traded or transferred between persons without an intermediary or custodian of value.

• **Wyoming enacts Wyoming Utility Token Act.** On February 28, the governor of Wyoming signed into law HB 062, classifying certain open blockchain tokens ("utility tokens") with consumptive characteristics as intangible personal property and providing that these tokens are not subject to a securities exemption. The bill also grants new oversight and investigatory authority to the Secretary of State regarding utility tokens, including additional required details relating to notices of intent and classifying certain violations as unlawful trade practices.

• **Massachusetts Securities Division assembles FinTech panel.** As reported by American Banker, on March 7, 2018, the Massachusetts Securities Division unveiled a panel consisting of representatives from the blockchain and financial industries, and academia, to help companies understand financial regulations.

**Virtual Currency**

• **Utah sends bill to governor that exempts blockchain tokens from money transmission definition:** On March 21, 2019, the Utah Senate sent a bill to the Governor (SB 213) that would enact provisions related to blockchain technology. Specifically, the bill would define blockchain technology and a blockchain token – which is an electronic record that is recorded on a blockchain and capable of being traded between persons without an intermediary – and would exempt blockchain tokens from the definition of money transmission.

• **ULC announces Committee to Study Intersection of UCC and Digital Assets.** In response to Wyoming’s passage of Senate Bill 0125 [link to article below in Blockchain and Virtual currency], the Uniform Law Commission (ULC) announced that it formed a joint committee with the American Law Institute to study emerging technologies and urged states to "refrain from enacting legislation" which may conflict with provisions of the Uniform Commercial Code, pending the result of the Committee's work.

**CASES AND ENFORCEMENT ACTIONS**

**FEDERAL**
Commodities

- **CFTC issues consent order against a token trading platform.** The US Commodity Futures Trading Commission (CFTC) has entered into a consent order against 1Pool Ltd. and its owner and CEO Patrick Brunner for online offering of retail commodity transactions using bitcoin without registering with the CFTC. The order required the defendants to pay $246,000 as disgorgement and another $175,000 as a civil penalty and to repay all US customers the bitcoin previously held by the defendants on their behalf and valued at approximately $570,000.

Securities

- **SEC Corporation Finance Division will not recommend enforcement.** The SEC Division of Corporation Finance issued a no action letter stating that it would not recommend enforcement action to the SEC if, in reliance on the opinion of counsel that certain tokens are not securities, TurnKey Jet, Inc. (TKJ) offers and sells those tokens without registration under the Securities Act and Exchange Act. Of particular note was the fact that none of the funds from token sales would be used to develop the platform TKJ is developing to facilitate token sales for air charter services, the private blockchain network through which the tokens would be distributed, or the app that will allow users to access and use the platform. Another important factor was that the tokens will be immediately usable for their intended functionality – purchasing air charter services – at the time they are sold, and that the tokens would be marketed in a manner emphasizing the functionality of the token and not any potential for increase in their market value.

Virtual Currency

- **Bitcoin dealer sentenced to prison and ordered to forfeit profits.** On April 8, 2019 a US citizen living in Mexico was sentenced to two years in prison and ordered to forfeit more than $800,000 in profits realized from operating an unlicensed money transmitting business in connection with the sale of hundreds of thousands of dollars in bitcoin to more than 1,000 persons in the United States, without registering with the US Treasury Department's Financial Crimes Enforcement Network (FinCEN) and without implementing necessary anti-money laundering protections.

- **Peer-to-peer exchanger assessed monetary penalty.** FinCEN assessed a civil money penalty against Eric Powers for willfully violating the Bank Secrecy Act (BSA). Mr. Powers operated as a peer-to-peer exchanger of convertible virtual currency without complying with the BSA's money services business (MSB) requirements, including (a) registration with FinCEN as an MSB; (b) establishing and implementing an effective written anti-money laundering (AML) program; (c) detecting and adequately reporting suspicious transactions; and (d) reporting currency transactions. According to FinCEN, a peer-to-peer exchanger is a natural person engaged in the business of buying and selling convertible virtual currency, who typically advertises and markets his or her services through classified ads, specifically designed web platform websites, online forums, other social media, and word of mouth. FinCEN noted that Mr. Powers made postings on various forums advertising his intent to purchase and sell bitcoin for others, and that he completed sales and purchases by (i) physically delivering or receiving currency in person, (ii) sending or receiving currency through the mail, or (iii) coordinating wire transactions. Note that to show "willfulness," FinCEN needs to only show that the individual acted with either reckless disregard or willful blindness. Powers admitted to these violations and FinCEN assessed him a $35,350 civil money penalty.

- **DOJ indictment of virtual currency trading company.** The DOJ announced on March 26, 2019 the indictment of Patrick McDonnell, the owner and operator of CabbageTech, a purported virtual currency trading company, on nine counts of wire fraud.

- **DOJ indsct operator of virtual currency trading company.** The DOJ announced on February 27, 2019 the indictment of Randall Crater, the founder of My Big Coin Pay, Inc., a purported virtual currency trading company, on four counts of wire fraud and three counts of money laundering. The indictment alleges Mr. Crater misappropriated over $6 million in investor funds for his personal use.

- **DOJ announces arrest in virtual currency pyramid scheme.** The DOJ announced on March 8, 2019 the arrest of Konstantin Ignatov and Rujia Ignatov under charges of wire fraud conspiracy and, with respect to Rujia Ignatov, charges of wire fraud, securities fraud and money laundering, for allegedly operating a multibillion-dollar international pyramid scheme selling a fraudulent cryptocurrency called OneCoin.

- **Announcement of international enforcement group.** On June 28, 2018, the IRS (together with tax authorities from the United Kingdom, the Netherlands, Canada and Australia) announced formation of an international enforcement group to fight crime and speed up responses to financial data dumps like the Panama Papers. A specific area of focus for this group is use of crypto- and virtual currency for illicit financing and drug trafficking, although the IRS also mentioned gain recognition avoidance as an IRS-specific concern.
• IRS announcement of compliance campaign. On July 2, 2018, the IRS announced five new compliance campaigns, including one that “will address noncompliance related to the use of virtual currency through multiple treatment streams including outreach and examinations.” In its announcement, the IRS hinted at “future guidance” on these issues, but the campaign seems directed primarily at noncompliance, although the IRS said that it “is not contemplating” the use of a voluntary disclosure program for virtual currency compliance.

• Lawmakers press the IRS for additional tax guidance on virtual currency. On April 11, 2019, 21 lawmakers sent a letter to IRS Commissioner Charles Rettig urging the IRS to provide clarity on a variety of virtual currency questions. The IRS issued guidance on the treatment of virtual currencies in 2014, but has not updated its guidance to address myriad issues, for example, the tax treatment of “forks” and other advances in the virtual currency space. The letter notes that guidance is urgently needed in three specific areas: (i) acceptable methods for calculating the cost basis of virtual currencies; (ii) acceptable methods of cost basis assignment and lot relief for virtual currencies; and (iii) the tax treatment of forks for taxpayers that use virtual currencies. The lawmakers noted further that these three areas are not the only areas that require further IRS guidance. The lawmakers asked the IRS for a written response by May 15, 2019.

STATE

Virtual Currency

• NY Regulator rejects Bittrex’s currency exchange license. The New York State Department of Financial Services rejected Bittrex’s application for a virtual currency license due to severe compliance failures. In a letter sent to the company and made public on Wednesday, April 10, DFS said it had issued several deficiency letters since the exchange first submitted an application, addressing Bittrex’s anti-money laundering procedures, Office of Foreign Assets Control compliance and its coin listing process, but that substantial issues remained unaddressed.

• NY DFS Official Publishes Op-ed on Bittrex license denial. On April 18, 2019, the Executive Deputy Superintendent for Banking of the New York Department of Financial Services (DFS), Shirin Emami, published an article explaining the DFS’s denial of Bittrex’s application for a currency exchange license. The article was updated after publication to add a response from Bittrex.

• NY regulator grants virtual currency license to Tagomi Trading. The New York State Department of Financial Services on March 27, 2019 announced it has granted a virtual currency business activity license to Tagomi Trading LLC, a virtual currency trading company. Tagomi is the 14th company to receive a BitLicense from the DFS.

• TX regulator issues cease and desist order against investment scheme for virtual currency mining. The Texas State Securities Board has issued a cease and desist order against Mintage Mining, LLC, BC Holdings and Investments, LLC DBA Mintage Mining, Social Membership Network Holding, LLC, NUI Social, LLC and Darren Olayan, for offering and selling investments related to cryptocurrency mining which were held to be unregistered securities. The respondents were also assessed a fine of $25,000.

COMING EVENTS

SEC Staff to Hold Fintech Forum on Distributed Ledger Technology and Digital Assets. The Securities and Exchange Commission announced that it will host a public forum focusing on distributed ledger technology (DLT) and digital assets on May 31, 2019, organized by the SEC’s Strategic Hub for Innovation and Financial Technology (FinHub). The forum will feature panelists from industry and academia and will include discussions about initial coin offerings, digital asset platforms, DLT innovations, and the impact on investors and the markets. The forum will be held live at the SEC’s Washington, DC headquarters and will be webcast live via the SEC’s website.

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