



Blockchain and Digital Assets News and Trends

Achieving Digital Transformation and Securing Digital Assets

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 seventh 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.

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

INSIGHT

IRS provides long-awaited guidance on taxation of cryptocurrency

By Tom Geraghty

Nearly five years after its first and only published guidance on the tax treatment of cryptocurrency, on October 9, 2019, the IRS issued Revenue Ruling 2019-24 (addressing the tax consequences of "forks") and an expanded FAQ (which applies the principles outlined in Notice 2014-21 to a larger number of situations). The additional guidance provides welcome clarity to a number of outstanding questions. Find out more.

FEDERAL DEVELOPMENTS

Digital assets

- **SEC reluctant to establish definition of digital assets.** William Hinman, Director of the Division of Corporate Finance of the SEC, spoke at the Cardozo Law School regarding the regulation of digital assets on September 16. Reportedly, Director Hinman discussed applying the Howey test to digital securities and how the many variables that apply to most ICOs preclude a "bright line" approach.
- **CFTC, FinCEN and SEC issue joint statement on activities involving digital assets.** On October 11, the leaders of the CFTC, FinCEN and SEC issued a joint statement regarding anti-money laundering and counter-terrorism (AML/CFT) obligations under the Bank Secrecy Act impacting persons engaged in activities involving digital assets. The agencies reminded market participants that the nature of the activities relating to digital assets performed by such persons is a key factor in determining whether and how that person must register with the agencies – regardless of the label or terminology, or technology, that such persons use in connection with, or to characterize, the activity or the assets. Read more.

Securities

- **First Regulation A+ token offering raises more than \$23 million.** In the July issue, we reported blockchain startup, Blockstack PC, received SEC approval to launch the first Reg A+ Security Token Offering (STO). On September 12, Blockstack reported that the offering closed with the participation of more than 4,500 individuals and entities, purchasing more than \$23 million in Stack digital tokens (including both the Reg A+ offering and the Reg S offering to investors outside the US).
- **Bitcoin ETF proposal withdrawn.** In our June and August issues, we reported on the delays in the SEC's review of the Bitcoin EFT products from VanEck SolidX Bitcoin Trust, and the proposed rule change of Cboe BZX Exchange to list and trade shares of the VanEck Solid X Bitcoin Trust. On September 13, Cboe BZX Exchange withdrew its proposed rule change. No reasons for the withdrawal were provided in the filing.
- **SEC staff asserts bitcoin is not a security.** On October 1, the Division of Investment Management of the SEC sent a response letter to Cipher Technologies Management LP, an investment fund, asserting that Cipher would not be an

“investment company” under the Investment Company act if it intends to invest substantially all of its assets in bitcoin. The SEC found bitcoin to not be a security under the *Howey* test and the SEC’s Framework for ‘Investment Contract’ Analysis of Digital Assets.

- **SEC rejects listing or trading of bitcoin exchange-traded fund.** On October 9, the SEC rejected the proposed rule change requested by NYSE Arca relating to the listing and trading of shares of the Bitwise Bitcoin ETF Trust. The Commission explained its disapproval of the proposed rule change was due to the failure of NYSE Arca to meet its burden under the Exchange Act and the Commission’s Rules of Practice to demonstrate that its proposal is consistent with the requirement that the rules of a national securities exchange be “designed to prevent fraudulent and manipulative acts and practices.” We reported on the SEC’s extension of consideration of ETFs in our August issue. No bitcoin ETF proposal has been granted by the SEC, and the only proposal still pending was filed by Wilshire Phoenix and NYSE Arca - reported in our July issue.

Blockchain

- **US House passes bill requiring FinCEN to study blockchain.** On September 19, the House of Representatives passed H.R. 2613, the Advancing Innovation to Assist Law Enforcement Act, mandating FinCEN to conduct a study of the implementation and use of AI, blockchain and other innovative technologies, and to consider how such technologies can improve bureau operations. The bill requires FinCEN to report its findings and determinations to the House Financial Services Committee and the Senate Banking Committee. The bill was forwarded to the Senate for consideration.

Virtual currency

- **Congressmen ask the Federal Reserve to create a digital dollar.** Senior House Financial Services Committee Members, Representative French Hill (R-Ark.) and Representative Bill Foster (D-Ill.), sent a letter to Federal Reserve Chairman James Power on September 30 asking if the Fed was investigating creating its own central bank-issued digital currency (CBDC) and setting forth their concerns regarding the risks to the US dollar if a private entity or another country first creates a widely adopted cryptocurrency. The letter describes the Fed’s right to create and manage US currency policy and requested the Fed’s views on the development of a US CBDC and potential market risks.

Commodities

- **CFTC Chairman asserts ether is a commodity – not a security.** Speaking at the Yahoo! Finance All Markets Summit on October 10, CFTC Chairman Heath Tarbert asserted that ether, an established cryptocurrency, is a commodity. “We’ve been very clear on bitcoin: bitcoin is a commodity. We haven’t said anything about ether – until now,” Chairman Tarbert said. “It is my view as chairman of the CFTC that ether is a commodity.” He continued stating that the CFTC is working with the SEC on the two cryptocurrencies and have agreed both are not securities.

FinTech

- **CFTC Second Annual Fintech Forward Conference registration opens.** The CFTC announced on October 3 that registration is now open for the CFTC’s Second Annual Fintech Forward Conference. The Conference will be held on October 24 at the CFTC Washington, DC, headquarters. The Conference theme this year is “Exploring the Unwritten Future,” and it will convene innovators, regulators, market participants and the public to discuss fintech developments and the impact of emerging technologies on markets and customers.

INDUSTRY DEVELOPMENTS

- **Industry cryptocurrency rating council established.** Coinbase announced on September 30 that it and other large cryptocurrency financial services companies have formed the Crypto Rating Council, a member-operated organization, which has established a ratings system to determine if particular digital assets are likely to meet the SEC’s definition of a security. The ratings system is derived from SEC guidance and case law, and utilizes the Council’s framework to rate an asset on a scale of 1 to 5. The Council asserts that its system will support the growth and adoption of digital assets and blockchain technologies. Founding members of the Council are Anchorage, Bittrex, Circle, Coinbase, DRW Cumberland, Genesis, Grayscale Investments and Kraken.
- **Chamber of Digital Commerce publishes fifth report on “Understanding Digital Tokens” 2nd edition.** On October 9, the Chamber of Digital Commerce released its fifth report, “Considerations & Guidelines for Advancing

Cybersecurity in the Token Economy”, included in the second edition of its series on “Understanding Digital Tokens.” In this segment, the Chamber addresses cybersecurity considerations for public blockchains and explores regulatory considerations from a cybersecurity perspective, addressing the application of both new and existing frameworks. The first four reports of the second edition have already been published: Considerations and Guidelines for Securities and Non-Securities Tokens, Market Overviews and Trends in Token Project Fundraising Events, Considerations and Guidelines for Consumer Protection, and Guidelines for Anti-Money Laundering Compliance and Combatting the Financing of Terrorism. This second edition serves as a follow-on to the Chamber’s initial report, released in 2018.

ENFORCEMENT ACTIONS

FEDERAL

Securities

- **SEC halts Telegram’s \$1.7 billion token launch.** On October 11, the SEC announced that it filed a complaint seeking an emergency action and obtained a temporary restraining order against Telegram Group Inc. and its wholly-owned subsidiary TON Issuer Inc. (collectively, “Telegram”), on the basis that Telegram is allegedly conducting an unregistered, ongoing public offering of digital securities called “Grams.” Between January 2018 and March 2018, the SEC alleges that Telegram raised approximately \$1.7 billion from sales of approximately 2.9 billion Grams to 171 purchasers in the United States and overseas, using the proceeds to capitalize its business and finance the creation of its blockchain. This original sale from 19-21 months ago, the SEC asserts, was just an initial step to begin a distribution to the public, the next step in which is to “flood the US capital markets with billions of Grams by October 31, 2019.” The SEC claims that this overall distribution constitutes a violation of Section 5 of the Securities Act, which requires that all offers and sales of securities be registered with the SEC unless an exemption is available. Since no exemptions would allow unrestricted issuances to the public at large, if the SEC’s theory is correct, the Telegram offering would have to be unwound or materially modified. This matter may have significant implications for other token issuers, including those who sold SAFTs or other rights to receive tokens. A hearing is scheduled for October 24, 2019.
- **Blockchain tech company to pay \$24 million penalty for unregistered ICO.** On September 30, the SEC announced settled charges against Block.one, a Cayman Islands blockchain technology company with operations in Virginia and Hong Kong, for conducting an unregistered initial coin offering of digital tokens that raised the equivalent of several billion dollars. The company agreed to a cease and desist order and to pay a \$24 million civil penalty. According to the order, Block.one stated that it would use the capital raised in the ICO for general expenses and to develop software and promote blockchains based on that software; however, the ICO was not registered as a securities offering and it did not qualify for an exemption from registration.
- **SEC charges token sale platform with securities violations.** On September 18, the SEC filed a complaint against ICOBox and its founder, Nikolay Evdokimov, alleging violations of the registration and broker-dealer provisions of the securities laws in connection with its 2017 token offering and other activities. According to the SEC, the defendants raised \$14.6 million from more than 2,000 investors by selling “ICOS” tokens. Defendants also facilitated the sale of ICOs on behalf of third parties, raising more than \$650 million. Defendants promised “ICOS” token holders that they could swap their tokens for other tokens promoted on the platform at a discount. The SEC seeks restitution with interest, as well as civil monetary penalties and injunctive relief.
- **SEC obtains consent judgment against adult entertainment marketplace.** On September 24, the SEC announced charges against Jonathan Lucas, founder and CEO of Fantasy Marketplace, for running a fraudulent ICO scheme. The complaint alleged that customers could purchase platform tokens for use to request live adult performances on the platform. Lucas’s 2017 ICO raised 63,000 from more than 100 investors, although Lucas claimed to have raised \$2 million. The SEC complaint was accompanied by a consent judgment, in which Lucas agreed to return the investors’ money and consented to a judgment that included a civil penalty of \$15,000 and a ban on his participation in certain securities offerings.
- **SEC obtains \$225,000 settlement with cryptocurrency startup.** The SEC settled an administrative proceeding against Nebulous, Inc. on September 30. Nebulous, a designer of cloud data storage technology, developed the “Sia” network, a peer-to-peer file storage network based on blockchain technology. According to the SEC, Nebulous sold securities – “Siastock” and “SiaNotes” – in 2014 and 2015 in violation of the federal securities laws. Siastock entitled holders to a percentage of future revenue from the Sia network transactions and user applications; SiaNotes were convertible into Siastock. Nebulous raised about \$120,000 in the offerings and paid about \$225,000 in penalties and disgorgement in the SEC settlement. The Commission also granted Nebulous’ request for a waiver of the “bad actor” provisions under Regulation A and Regulation D, thereby permitting Nebulous and its affiliates to offer securities under

those provisions in the future in accordance with certain representations set forth in the request letter.

STATE

Virtual currency

- **Missouri Secretary of State orders cryptocurrency company to cease and desist.** On October 2, the Securities Division of the Missouri Secretary of State announced that it ordered unregistered firm Mavixbtc Limited, a St. Louis cryptocurrency company, to cease and desist offering brokerage and investment advisory services regarding investments in cryptocurrency. Mavixbtc allegedly misled investors by falsely claiming to be registered with FINRA and the SIPC and touting returns of up to 55 percent. The Division ordered Mavixbtc to show cause why restitution, civil penalties and investigation costs of more than \$30,000 should not be imposed.
- **SEC obtains \$6.8 million judgment against cryptocurrency company.** On September 30, the SEC announced that a New York federal court entered a default judgment against Longfin Corp. ordering Longfin to pay \$6,755,848 in penalties and disgorgement of all proceeds raised in a fraudulent public offering and resulting from sham commodities transactions. The SEC complaint alleged that Longfin falsely represented in SEC filings that the company operated in the US and misrepresented the number of shareholders and shares sold in the offering.
- **New lawsuit filed against Bitfinex and Tether claims damages of over \$1.4 trillion.** A Class Action Complaint was filed on October 7 in the Southern District of New York claiming that Bitfinex, Tether and related companies defrauded investors and manipulated the cryptocurrency markets. The Complaint alleges fraud, money laundering, monetary transactions derived from specified unlawful activities, wire fraud and operating an unlicensed money transmitting business. Specifically, the plaintiffs assert that “tether” tokens (“stablecoins” purportedly backed 1:1 by the US dollar), were improperly issued in quantities well exceeding the company’s reserves and used to purchase other cryptocurrencies to inflate the crypto market. For information on the criminal cases pending against Bitfinex and Tether, see our May issue.

Commodities

- **New York indicts principal of cryptocurrency escrow company.** On September 30, the US Attorney for the Southern District of New York announced an indictment against Jon Barry Thompson, principal of Volantis Escrow Platform LLC and Volantis Market Making LLC, for two counts of commodities fraud and two counts of wire fraud for defrauding two companies out of \$7 million in bitcoin. Thompson faces up to 60 years in prison on all four counts. The Commodity Futures Trading Commission (CFTC) also filed civil charges against Thompson for the false representations. The CFTC seeks an injunction, disgorgement, restitution, rescission of contracts and civil monetary penalties.

Recent Publications

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

Upcoming Events

eSignRecords2019, November 11-13, 2019, Orlando, Florida. The agenda of the Electronic Signatures and Records Association Annual Conference includes discussion of “Blockchain: Beyond Cryptocurrency.”

Trending

SEC proposed to modernize certain rules: transitioning from a prescriptive to a principles-based approach?

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

The September 2019 issue of *eSignature and ePayment News and Trends*

Read this next

On October 7, 2019, the United States Supreme Court denied certiorari in *Domino's Pizza, LLC v. Robles*. Domino's Pizza requested the high court to review the Ninth Circuit's decision holding that Domino's must make its website accessible to persons with visual impairments under the Americans with Disabilities Act (ADA). Read more here.

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.

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.

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