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Virtual Currency Is a Commodity Regulated by the CFTC, Eastern District of New York Rules

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A federal court this week found that the U.S. Commodity Futures Trading Commission (CFTC) had jurisdiction to regulate a cryptocurrency business, raising the possibility of jurisdictional tension among the CFTC and other federal agencies over the regulatory future of the emerging industry.

The CFTC charged Patrick K. McDonnell and CabbageTech, Corp. (d/b/a Coin Drop Markets) in January "with fraud and misappropriation in connection with purchases and trading of Bitcoin and Litecoin" in the Eastern District of New York. On February 15, McDonnell filed a *pro se* motion to dismiss the charges, arguing that the CFTC did not have jurisdiction to bring this action because virtual currencies are not commodities—or, alternatively, that the CFTC can only regulate virtual currency derivative products.

Since late 2015, in the *Coinflip* case, the CFTC has officially asserted that "Bitcoin and other virtual currencies are . . . properly defined as commodities." The CFTC reasoned that because virtual currency "is a digital representation of value that functions as a medium of exchange, a unit of account, or a store of value," it fits within the broad definition of "commodity" under the Commodities Exchange Act. According to the CFTC's Chairman, J. Christopher Giancarlo, that grants the CFTC the power to not only regulate virtual currency derivative products (like options, swaps, or other leveraged transactions) but also "enforcement jurisdiction" to subpoena, investigate, and bring civil enforcement actions "against fraud and manipulation . . . in underlying virtual currency spot markets just like other commodities." The CFTC was only recently awarded this broad regulatory power under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and it appears that with regard to virtual currency, in CabbageTech and other cases, the CFTC is asserting its belief that this authority extends to virtual currency.

EDNY Judge Jack Weinstein on Tuesday agreed with the CFTC's interpretation of its own power, ruling that virtual currencies are commodities and that the CFTC had jurisdiction to regulate fraud and manipulation in underlying virtual currency spot markets. As part of the opinion, Judge Weinstein accepted—in totality—the CFTC's previous guidance on this subject.

This is the first opinion from a federal court affirming the CFTC's jurisdiction to regulate virtual currency spot and derivative markets. Judge Weinstein's opinion focused on a key issue for virtual currency issuers and exchanges: which federal or state regulatory agency should be in charge of regulating virtual currency? Judge Weinstein's answer: "[t]he jurisdictional authority of CFTC to regulate virtual currencies as commodities does not preclude other agencies from exercising their regulatory power when virtual currencies function differently than derivative commodities." This answer is far from definitive and certainly suggests that depending on how the virtual currency is used—as a commodity or security, as property or as a vehicle to transfer value—the CFTC, U.S. Securities and

Exchange Commission (SEC), FinCEN, IRS, U.S. Department of Justice (DOJ), or state regulatory and prosecutorial bodies may have an interest in regulation or enforcement.

This opinion raises the possibility of jurisdictional tension between the CFTC and the SEC, which has recently brought a number of civil enforcement actions against virtual currency issuers premised on the theory that the virtual currency in question is an unregistered security. A finding that a given virtual currency is, in fact, a commodity—rather than a security—could deprive the SEC of jurisdiction over that issuer, and vice versa with respect to instances in which a currency is deemed a security.

A further possibility, however, is that a particular virtual currency with limited or no early utility might constitute a security at the time of its issuer's initial coin offering, but later evolve into a commodity once its utility is established. The prospect exists that both the SEC and CFTC could have jurisdiction over a single virtual currency at different times in its market lifecycle.

Ballard Spahr's Virtual Currency Group is well-positioned to help clients maintain compliance with SEC and CFTC regulations. Our attorneys focus on legal areas critical to virtual currency providers, such as securities regulation and enforcement, white collar defense and investigations, anti-money laundering, tax, intellectual property, and privacy and data security.

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