



CFTC and Virtual Currencies: New Court Rulings and Implications for Congress

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Over the past few months, several federal district courts have ruled in favor of the Commodity Futures Trading Commission (CFTC) in its first wave of fraud-based enforcement actions involving Bitcoin and other virtual currencies (also referred to as digital currencies, cryptocurrencies, digital tokens or digital coins). With several district court judges [now agreeing](#) with the CFTC’s position that virtual currencies are “commodities” as defined in the Commodity Exchange Act (CEA or Act), new legal authority supports the CFTC’s efforts in enforcing against fraud and manipulation, in addition to carrying out certain other powers, in the virtual currency realm. With these new rulings come possible new legal questions that Congress may consider, including the decisions’ implications for the CFTC’s enforcement authority and the overall scheme of regulation for digital coins. Moreover, as discussed further below, the new case law, coupled with enforcement activity underway by the Securities and Exchange Commission (SEC) with respect to digital coins, means that the CFTC shares regulatory authority in the cryptocurrency space with several other regulators. This Sidebar addresses these issues by providing background on the CFTC’s regulatory role and discussing the recent judicial opinions concerning its authority over virtual currencies, before highlighting areas of potential overlap—as well as gaps—existing in the current federal regulatory framework for virtual currencies.

CFTC Authority Under the Commodity Exchange Act

The [CFTC](#) is the primary federal agency charged with overseeing markets in [derivatives](#)—i.e., financial contracts that “derive” their value by reference to an underlying asset (or rate or index), whose prices rise or fall based on fluctuations in the value of that underlying asset. Derivative contracts generally stand in contrast to, for example, contracts for the sale of a good or asset that is itself promptly delivered to the other party. The CFTC has regulatory authority over derivatives including commodity [futures](#), [options](#), and (more recently as a result of [Dodd-Frank](#)) [swaps](#). The [CEA regulates](#) trading in commodity futures and contains the statutory framework under which the CFTC operates. (It should be noted that the CFTC generally does [not](#) have regulatory oversight authority over “[spot](#)” trading, as opposed to derivatives trading, in commodities). For example, the CEA requires the registration of exchanges and platforms for trading in certain derivatives, such as [designated contract markets](#) (i.e., futures exchanges) and [swap execution facilities](#) (i.e., systems or platforms for multiple participants to engage in swap trading).

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The CFTC's [enforcement authority](#) under the CEA also allows it to police against fraud and manipulation (i.e., "any manipulative or deceptive device or contrivance") in the sale of futures, swaps, and commodities. This anti-fraud enforcement power is somewhat broader than the CFTC's general oversight authority over derivatives in the sense that it extends beyond derivatives contracts to any "contract of sale of any *commodity* in interstate commerce." The CEA's anti-fraud provision, which Congress [expanded](#) through [Dodd-Frank](#), generally [requires](#) the CFTC to show that a defendant made a material false statement or omission with scienter in connection with a relevant transaction. (Some commentators note that it also appears the CFTC may be [poised](#) to enforce against insider trading in futures, swaps, and commodities under this provision and the CFTC's [Rule 180.1](#) promulgated pursuant to Dodd-Frank.)

Recent Anti-Fraud Cases and Virtual Currencies as Commodities

As noted, over the past few months, several federal district courts have rendered favorable rulings for the CFTC as the agency has relied on the CEA's anti-fraud provision to combat fraudulent conduct in connection with sales of virtual currencies. For example, in August, in [CFTC v. McDonnell](#), the CFTC prevailed before a federal court in New York against a trader who misappropriated customers' funds and made false statements regarding trading strategy and expected returns from purchases and sales of Bitcoin. A month later, in [CFTC v. My Big Coin Pay, Inc.](#), the CFTC, before a Massachusetts federal court, successfully opposed a motion to dismiss by defendants who had allegedly sold a virtual currency called "My Big Coin" to customers while falsely claiming that the currency was backed by gold, could be used wherever MasterCard was accepted, and was actively traded on currency exchanges. (A few weeks after that ruling, in [CFTC v. Gelfman Blueprint, Inc.](#), the CFTC also obtained a default judgment against defendants who had operated a Ponzi scheme in which they purported to execute sales of Bitcoin on behalf of customers through a sophisticated algorithmic program.)

The [McDonnell](#) and [My Big Coin](#) decisions are notable because they relied on virtual currencies' status as "commodities" as the basis for the CFTC's enforcement power under the CEA (as neither case involved trading in derivatives), suggesting that the CFTC has broad authority to police against fraud in the sale of virtual currencies in interstate commerce. In this regard, the CEA's [definition](#) of "commodity" is very broad. Given the CFTC's historical focus on futures in agricultural commodities, the definition first enumerates a host of agricultural goods (such as wheat, cotton, rice, etc.). A [1974 amendment](#) to the Act, however, expanded the definition of commodity in order to [reflect](#) the evolving futures markets, allowing for CFTC regulation of the growing industry. The amendment therefore broadly specifies that the definition of commodity also includes "all other goods and articles . . . and all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in." Because the CEA's definition of "commodity" is linked to goods and articles traded in futures markets, it has expanded [over time](#) to include energy and metal commodities, as well as financial instruments, such as interest rates (e.g., LIBOR), stock indices, and foreign currencies. As the U.S. Court of Appeals for the Seventh Circuit noted in a 1982 [decision](#), "[b]y this amendment, literally anything other than onions [which were specifically exempted in the statute] could become a 'commodity' . . . simply by its futures being traded on some exchange."

The CFTC has taken the position that Bitcoin is a commodity for a number of years (dating back, for example, to its Chairperson's [testimony](#) before a congressional committee in 2014 and its finding in a 2015 [administrative action](#) that a Bitcoin options and futures trading platform violated the Act by failing to register), a view now bolstered by the recent anti-fraud rulings. Earlier this year, Senior Judge Jack B. Weinstein issued an opinion in the [McDonnell](#) case, in which he [reasoned](#) that the Bitcoins at issue qualified as commodities, both under the common usage of the term (as "goods exchanged in a market for a uniform quality and value") and under the CEA, [noting](#), among other things, the trading of Bitcoin futures on certain major exchanges. Similarly, in [My Big Coin](#), a Massachusetts federal district court [agreed](#) with the CFTC that the virtual currency "My Big Coin" was a commodity subject to the CFTC's

anti-fraud enforcement because it was undisputed that “contracts for future delivery of virtual currencies are ‘dealt in’”—namely looking to “the existence of Bitcoin futures contracts.” The court viewed virtual currencies as a class, [rejecting the](#) defendant’s argument that My Big Coins did not qualify as commodities because that specific virtual currency is not traded in futures markets. As a result, the logic of *My Big Coin* suggests that the CEA authorizes the CFTC to regulate fraud with respect to both well-established cryptocurrencies, like Bitcoin, as well as other burgeoning digital coins.

These rulings likely signal that the CFTC will [continue](#) to actively enforce against fraud and manipulation in the sale of a variety of virtual currencies. In addition, while not discussed further here, the CFTC has also ramped up efforts to tackle fraud in cases where defendants solicited virtual currency from customers as investments, for purposes of conducting trading in derivatives or other commodities that implicate the CFTC’s jurisdiction (for example, in *CFTC v. Dean* and *CFTC v. Hunt*). These additional cases indicate that the CFTC has also taken an interest in fraud and manipulation involving virtual currencies more broadly than cases strictly involving sales of the currencies themselves.

Implications for Congress

Particularly in light of the *My Big Coin* holding, the courts’ findings that virtual currencies are “commodities” raises several issues that Congress may consider. First, the rulings highlight the potential for regulatory overlap (and perhaps confusion) in the virtual currency realm. The *McDonnell* court explicitly [noted](#) that, unless Congress “clarifies the matter, the CFTC has concurrent authority” over virtual currencies along with a host of other state and federal entities, including, in varying capacities, the SEC, the IRS, and the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN). The SEC, for example, has taken the [position](#) that certain virtual currencies qualify as “securities,” subject to the federal securities laws under its purview, depending on the facts and circumstances. (For a detailed analysis of virtual currencies as securities and application of the federal securities laws to Initial Coin Offerings, see this [report](#).)

Second, the recent rulings, which solely pertained to the CFTC’s *anti-fraud* authority with respect to sales of virtual currencies, underscore the current patchwork nature of federal regulation of virtual currencies. For instance, because the CFTC generally does [not](#) have regulatory authority over spot “commodities” markets (apart from its powers to police against fraud and manipulation), as CFTC Chairman J. Christopher Giancarlo noted in [testimony](#) before the Senate Banking Committee earlier this year, “current law does not provide any U.S. Federal regulator with . . . regulatory authority over spot virtual currency platforms operating in the United States or abroad.” While some, like Chairman Giancarlo have urged Congress to consider legislation to expand the federal regulatory role on this front, [others](#) believe that regulation could have negative impacts by stifling growth and innovation.

Some congressional concerns regarding the regulatory framework for virtual currencies have endured in the 115th Congress, and are [likely](#) to be the subject of further debate in the 116th. A [resolution](#) introduced in the House of Representatives this fall entitled “Expressing support for digital currencies and blockchain technology” stated, among other things, that “United States Federal agencies should work toward a coordinated framework to support digital currencies . . .” and highlighted the need to “allow[] consumer protection while supporting future innovation.” In that vein, two bills introduced on December 6, 2018 would require the CFTC to submit reports to Congress on topics including, respectively, (1) price manipulation in virtual currencies ([H.R. 7224](#)) and (2) regulation of virtual currency markets in the United States as compared with other countries ([H.R. 7225](#)). Of particular relevance to the issues raised in this Sidebar, the latter report would include a “clarif[ication] [of when] virtual currencies . . . qualify as commodities” and “provide a new, optional regulatory structure for virtual currency spot markets.”

Other individual bills addressing virtual currency introduced in the 115th Congress have largely focused on the specific issues of detecting money laundering through virtual currencies (for

example, [H.R. 5036](#)) or virtual currencies' treatment for tax purposes (for example, [H.R. 3708](#)). Nonetheless, [commentators](#) have predicted that more comprehensive reform may soon be on the congressional agenda.

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