Not All Virtual Currencies are Created Equal: Regulatory Guidance in the Aftermath of \textit{CFTC v. McDonnell}

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NOT ALL VIRTUAL CURRENCIES ARE CREATED EQUAL:
REGULATORY GUIDANCE IN THE AFTERMATH OF CFTC V.
MCDONNELL

ALLEN KOGAN*

I. Introduction .................................................................................................................. 200
II. Virtual Currencies — In General ................................................................................ 202
   A. What Are Virtual Currencies? .............................................................................. 202
   B. Permissioned, Convertible, Both, or Neither? .................................................. 203
   C. Key Distinctions Between Prominent Networks .............................................. 204
      1. Bitcoin ........................................................................................................... 204
      2. Ethereum & Smart Contracts ........................................................................ 205
      3. Other Networks ............................................................................................ 206
   D. DLT-based Derivatives & Investment Vehicles ..................................................... 208
III. Federal Courts & Regulators .................................................................................... 209
   A. Securities & Exchange Commission ("SEC") ..................................................... 210
   B. Commodities Futures Trading Commission ....................................................... 211
   C. CFTC v. McDonnell ......................................................................................... 214
   D. Other Case Law ................................................................................................ 215
      1. Securities ......................................................................................................... 216
      2. Commodities ................................................................................................. 217
IV. Are Virtual Currencies Commodities? ..................................................................... 219
   A. Bitcoin is a Commodity ..................................................................................... 219
      1. Commodities Exchange Act § 1a(9) ................................................................ 220
      2. Case Law ......................................................................................................... 220
   B. But CFTC Jurisdiction Stops There — The Dealt-in Requirement ......................... 221
      1. “Can Be” or “Are Being?” ............................................................................... 222
      2. General or Specific? ....................................................................................... 223
      3. Is “Virtual Currency” a Product Category? .................................................... 224
   C. Does It Even Matter? .......................................................................................... 226
      1. Futures & Swaps ............................................................................................. 226
      2. Interstate Commerce Jurisdiction .................................................................. 227
      3. Retail Jurisdiction & Exempt Commodities ................................................... 228
V. Why McDonnell Got It Wrong ..................................................................................... 229
   A. Misapplied Facts .................................................................................................. 229

199
I. INTRODUCTION

Virtual currencies have emerged as an innovative technological alternative for a multitude of tools and processes used by financial institutions, private businesses, and investors.\(^1\) However, contrary to popular belief, the term "virtual currency" encompasses many distinct, independently developed applications of Distributed Ledger Technology ("DLT").\(^2\) Moreover, the term "cryptocurrency" describes just one subsect of virtual currencies, which itself includes a vast array of different technologies with unique implementations, technological underpinnings, and end-uses.\(^3\) Consumers

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\(^2\) See FIN. ACTION TASK FORCE, KEY DEFINITION AND POTENTIAL AML/CFT RISKS 4 (2014) (defining “virtual currency”) [hereinafter KEY DEFINITIONS]; see also infra Section II.A (discussing key distinctions between networks and explaining DLT).

can already use one prominent virtual currency, Bitcoin, to make online purchases from a variety of popular online retailers, travel-booking sites, and even dating sites, with many others currently testing virtual currency payment-processing systems.4

As virtual currencies continue to gain popularity, major financial institutions are working with developers to further broaden the variety of financial tools and investment vehicles based on blockchain networks.5 Foreseeably, a major question arose soon after individual investors began to speculate on virtual currency prices: how will they be regulated?6 Though United States (“U.S.”) federal courts and agencies are struggling to establish clear, definitive oversight of these digital assets, securities and commodities regulators have flexed their self-asserted regulatory muscle by bringing successful actions against developers.7 In one such action, Commodity Futures Trading Comm’n v. McDonnell,8 a federal court held for the first time that all virtual currencies are commodities, which are subject to the Commodity Futures Trading Commission’s (“CFTC”) jurisdiction.9

Part II of this Comment defines key terms and underscores that many virtual currencies are designed for drastically different purposes with highly distinct technological protocols. Part III discusses notable efforts by federal authorities to expand regulatory jurisdiction to virtual currencies, the sources of law they rely upon in doing so, and their successes in federal court thus far. Part IV analyzes the primary legal and practical issues with broadly classifying all virtual currencies as commodities, and Part V underscores the significant flaws in the McDonnell court’s reasoning in doing so. Part VI briefly analyzes the applicability of U.S. securities laws to virtual currencies and related investment offerings. Lastly, Part VII recommends that (1)


9. Id. at 229–30.
future case law resolve outstanding legal issues relevant to virtual currency classification and narrow the holding in *McDonnell*, and (2) that regulators develop a more precise regulatory scheme that accounts for the significant differences between individual virtual currency networks.

II. VIRTUAL CURRENCIES — IN GENERAL

Understanding key terms, technological distinctions between individual networks, and current efforts by U.S. regulators is essential to implementing a precise and effective classification mechanism for virtual currency regulation.

A. What Are Virtual Currencies?

The terms “virtual currency,” “cryptocurrency,” and “tokens,” inter alia, each refer to individual aspects of entirely distinct networks, which themselves are specific applications of a broader system known as “blockchain technology,” or simply “the blockchain.” Moreover, the blockchain is just one particular application of DLT for the narrow purpose of peer-to-peer information transfer through decentralized online networks. DLT is essentially a “consensus validation system” designed to replace centralized validation authorities with distributed ledgers, which exist across several online nodes — mainly computers — and maintain identical copies of user transactions to validate them in the future.

Rather unintuitively, and likely the source of much confusion among

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10. Cryptocurrencies, AUSTL. SEC. & INV. COMMISSION (last updated Oct. 24, 2018), https://www.moneysmart.gov.au/investing/investment-warnings/virtual-currencies (explaining that a blockchain is a virtual recording system which allows users to continuously add new records of data (the “blocks”) to its ledger (the “chain”) while permanently retaining all previously recorded transactions).


courts, not all virtual currencies use DLT; many cannot be used in place of fiat currency, and some even entirely lack monetary functionality.\textsuperscript{13} Instead, a virtual currency is simply “a digital representation of value” that exists only online, has no legal government-tender status, and can be traded as “(1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value.”\textsuperscript{14} “Cryptocurrencies” are a specific subset of virtual currencies that utilize DLT and secure transactions with cryptography, making them extremely difficult to counterfeit and therefore highly effective for use in financial transactions.\textsuperscript{15} A “token” is a tool most often used as a transactional unit on a virtual currency network.\textsuperscript{16} Tokens may represent virtually any asset or interest and exist in many different forms, dictated entirely by their intended use.\textsuperscript{17} Lastly, the term “digital currency” is often used to describe the digital (or online) representation of either a virtual or fiat currency.\textsuperscript{18}

\textbf{B. Permissioned, Convertible, Both, or Neither?}

Blockchain networks generally exist in two main forms: “permissioned” networks, which outside users cannot access without the owner’s permission, and “permission-less” networks, which “anyone can access and use.”\textsuperscript{19} Further, certain virtual currencies are “convertible,” meaning they can be either exchanged directly for fiat currencies or used entirely in their place to

\textsuperscript{13} See infra text accompanying notes 45–48 (discussing networks that, while lacking monetary value, can be traded as a “medium of exchange” of information); see also Mason v. Mach. Zone, Inc., 140 F. Supp. 3d 457, 465 (D. Md. 2015) (involving an non-DLT virtual currency which users purchase with fiat currency and can only employ within a closed virtual casino and cannot transfer elsewhere).

\textsuperscript{14} See Key Definitions, supra note 2, at 4; see also LABCFTC, supra note 11, at 4 (citing I.R.S. Notice 2014-21, https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies (providing the same definition); In re Coinflip, Inc., CFTC No. 15-29, 2015 WL 5535736, at *2 n.2 (Sept. 17, 2015) (providing the definition of Bitcoin as a virtual currency) [hereinafter Coinflip Order].

\textsuperscript{15} See Cryptocurrency, supra note 3.

\textsuperscript{16} Id.

\textsuperscript{17} Id.; Cryptographic Tokens, BLOCKCHAIN HUB, https://blockchainhub.net/tokens/ (last visited Feb. 4, 2019) (describing different types of tokens and their use by cryptocurrency networks).

\textsuperscript{18} See Key Definitions, supra note 2, at 4. However, due to its relatively inconsistent use and negligible import here, “digital currency” will not be used in this Comment. See, e.g., Andrew Tar, Digital Currencies vs. Cryptocurrencies, Explained, COINTELEGRAPH (Dec. 13, 2017), https://cointelegraph.com/explained/digital-currencies-vs-cryptocurrencies-explained (defining “digital currency” as synonymous with “virtual currency”).

\textsuperscript{19} See Key Definitions, supra note 2, at 4; see also infra text accompanying notes 37–39 (discussing Ripple, a permissioned network); Mason v. Mach. Zone, Inc., 140 F. Supp. 3d 457, 465 (D. Md. 2015) (involving a permissioned network that users could only access with the owner’s permission, granted to those purchasing in-game currency).
trade for physical goods or services. “Non-convertible” virtual currencies cannot be exchanged for fiat currencies, physical goods, or services because they are specifically designed for use within a closed (usually entirely virtual) domain.

C. Key Distinctions Between Prominent Networks

1. Bitcoin

The Bitcoin Network is the first-ever established cryptocurrency and the most popular virtual currency among speculative investors, consumers, and, consequently, financial regulators. This network is a permission-less blockchain designed to facilitate anonymous peer-to-peer financial transactions without reliance on a centralized authority to verify these transactions. The network’s token, Bitcoin, is convertible and transferable between individual virtual wallets that exist either online or locally on a computing device. This enables users to buy, sell, and exchange Bitcoin with each other directly for cash and through online exchanges using a credit card or a bank account.

Individuals can also “mine” Bitcoin by using computers (usually designed to generate enormous amounts of computing power) to solve complex algorithms that each generate one Bitcoin when solved. Because Bitcoins are finite in supply, they derive their value from: (1) supply and demand on the open market, (2) overall cryptocurrency market conditions, and (3) the network’s user-base, which pools assets to create, sustain, and change the

20. See Key Definitions, supra note 2, at 4; see also infra text accompanying note 24 (describing Bitcoin’s convertibility).

21. See Key Definitions, supra note 2, at 4; LabCFTC, supra note 11, at 4; see, e.g., Mason, 140 F. Supp. 3d at 465 (involving a non-convertible currency only useable in a virtual casino).


24. Id.

25. Id.

26. Id. at 3.
token’s value against fiat currencies. Currently, Bitcoin is mainly purchased specifically for returns on potential value appreciation by speculative investors. The price of Bitcoin — as well as that of most other cryptocurrencies — varies significantly based on the particular country, and even the particular exchange within a country, from which they are purchased. Bitcoin’s development also prompted later cryptocurrencies known as “alt-coins,” which seek to improve on specific aspects of Bitcoin’s coding protocol (such as user privacy or transaction speed, for example) while maintaining all of Bitcoin’s fundamental attributes discussed in this section. These, collectively with Bitcoin, are referred to as “Bitcoin-class networks” for the purposes of this Comment.

2. Ethereum & Smart Contracts

“Smart-contract” networks are a narrower subset of cryptocurrencies designed to accomplish a range of tasks vastly different from that of Bitcoin-class networks, and therefore employ entirely distinct coding protocols. Specifically, smart-contract cryptocurrencies seek to replace traditional paper contracts by offering two main advantages: (1) dramatically reduced costs associated with traditional contractual transactions, and (2) extensive security measures for securing these transactions.


32. See Ari Juels & William Marino, Understanding Smart Contract Mechanics, Practical Law Practice Note w-005-3262, PRACTICAL LAW – FINANCE (Mar. 1, 2017) (explaining that smart contracts are “a form of computer code run in a framework that resembles execution by a trusted third party” and are “helping enforce the terms of traditional legal agreements”); see also LabCFTC, A Primer on Smart Contracts, CFTC (Nov. 27, 2018), at 4–10 [hereinafter Primer on Smart Contracts] (explaining smart
The most popular smart-contract cryptocurrency among investors is Ethereum, a permission-less blockchain that operates on a coding protocol largely distinct from that of Bitcoin-class networks. Specifically, the Ethereum network stores not only transactional data regarding a native token, as Bitcoin-class networks do, but also code for “smart contracts,” which users can employ for a wide-range of tasks. This enables Ethereum’s native token, Ether, to be used not just for financial transactions (like tokens on Bitcoin-class networks), but also for facilitating virtual contract transactions, which enforce party obligations without reliance on a traditional central authority (such as a court or a mediator), while minimizing the counterparty risk associated with doing so. Like Bitcoin, Ether and similar smart-contract tokens operate on cryptocurrency networks, can be mined and are convertible.

3. Other Networks

Beyond the scope of convertible cryptocurrencies based on permissionless and Smart-contract networks, developers continue to create a broad array of new virtual currencies with entirely distinct coding protocols for drastically different and highly innovative uses. Ripple, for example, is a convertible cryptocurrency token based on a permissioned blockchain.

33. See Top 100 Cryptocurrencies by Market Capitalization, supra note 22, at 3; see also Julianne Harm et al., Ethereum vs. Bitcoin, THE ECONOMIST, 3–6 (last visited May 13, 2019) (explaining coding protocol distinctions between Bitcoin and Ethereum); ETHEREUM, supra note 31, at 4 (listing Ethereum’s intended uses, including the registry of debts, transactions under provided instructions — in a will or futures contract, for example, and the development of markets).

34. Id.; see also Primer on Smart Contracts, supra note 32, at 11–16 (listing potential benefits and uses of smart contracts, including derivatives, securities, supply chain management, record keeping, trade clearing, and insurance automation).

35. Id.; see also Primer on Smart Contracts, supra note 32, at 11–16 (listing potential benefits and uses of smart contracts, including derivatives, securities, supply chain management, record keeping, trade clearing, and insurance automation).

36. See Juels & Marino, supra note 32, at 4 (providing that these tokens are referred to as “Smart-contract networks”); see, e.g., Primer on Smart Contracts, supra note 32, at 4 (“Fundamentally, a ’smart contract’ is a set of coded computer functions.”); see also Ryan Smith, What is Tezos (XTZ)? A Beginner’s Guide to the Controversial Coin, COINCENTRAL (Aug. 20, 2018), https://coincentral.com/what-is-tezos-xtz-a-beginners-guide-to-the-controversy-coin/ (explaining Tezos, a smart-contract cryptocurrency similar to Ethereum which allows users to self-govern the network through voting).

37. See Phil Fersht, The Top 5 Enterprise Blockchain Platforms You Need to Know, HORSES FOR SOURCES (Mar. 16, 2016).
Accordingly, Ripple and similar networks offer the transactional efficiency and security of Bitcoin, but lack Bitcoin’s (almost complete) user-anonymity due to their reliance on a centralized authority for verifications.³⁹ Ripple’s coding protocol was specifically designed to facilitate fast, secure data and financial transfer transactions between large financial institutions, many of which are currently exploring the implementation of Ripple.⁴⁰

Certain virtual currencies issue tokens that derive their value from real-world assets, entirely irrespective of supply, demand, consumer popularity, and other external factors regarding the tokens themselves.⁴¹ Tether, for example, is a permission-less blockchain designed to enable businesses to efficiently access fiat currencies by supporting three different tokens on its network, each of which is fully backed by real-world fiat currency assets held in Tether’s reserve account.⁴² Accordingly, users of asset-backed networks cannot (theoretically, at least) manipulate the price of tokens.⁴³

Other virtual currency networks do not support tokens at all, and therefore have no monetary value.⁴⁴ For example, the Estonian government is

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³⁹. See Scott D. Hughes, Cryptocurrency Regulations and Enforcement in the U.S., 45 W. St. L. Rev. 1, 4–5 (2017). Ripple and similar networks are referred to as “Ripple-class networks” for the purposes of this Comment.


⁴². FAQs, TETHER, https://tether.to/faqs/ (last visited Jan. 22, 2019) (listing Tether’s tokens, USDT, EURT, and JPYT, which are backed by (and pegged to the price of) U.S. Dollars (USD), Euros (EUR), and Japanese Yen (JPY), respectively).


⁴⁴. Virtual currencies may also employ tokens which lack monetary value because they are not convertible. See, e.g., Mason v. Mach. Zone, Inc., 140 F. Supp. 3d 457, 465 (D. Md. 2015) (involving a non-convertible in-game currency only useable in a virtual casino).
currently implementing a permissioned cryptocurrency network called Keyless Signature Infrastructure (“KSI”) to store and protect all public-sector data.45 Because it records only the “hash values” of data records and prevents its (previously approved) users from accessing the actual information on these records, KSI does not employ tokens of any kind, and its only possible use is for tracking changes — the newly added blocks — to its records — the chains.46 Another similar network is R3, an open-source blockchain network developed comparatively by a group of the world’s largest financial institutions to efficiently manage complex internal financial agreements.47 Like KSI, R3 is permissioned network that has no native token, allowing only for informational transactions.48 KSI, R3, and other similar networks are referred to “Information blockchains” for the purposes of this Comment.

D. DLT-based Derivatives & Investment Vehicles

Financial institutions and private investment funds are now using virtual currencies as the basis of financial tools and investment vehicles. In December 2017, for example, the only virtual currency-based futures available to the public — Bitcoin futures — were officially listed for sale.49 Developers are also increasingly providing the public with access to Initial Coin Offerings (“ICOs”), which involve the crowd-funding of new networks through pre-release sales of tokens to early investors at a (speculatively) low-cost price.50 Further, many financial institutions and private investors now offer public access to cryptocurrency-based investment funds, or “cryptofunds,” which act exactly as traditional investment funds but instead rely on


48. Id.; see also Fersht, supra note 38 (“There is no built-in token or cryptocurrency for [R3], and it is a permissioned blockchain as it restricts access to data within an agreement to only those explicitly entitled to it, rather than the entire network.”).


the global cryptocurrency market as the source of their underlying investment vehicles.\textsuperscript{51} One notable crypto-fund that presented investors with a relatively unique opportunity was the Decentralized Autonomous Organization ("DAO"), an online venture capital fund designed to raise start-up capital for emerging blockchain projects.\textsuperscript{52} The DAO’s network provided each investor with DAO tokens in proportion to their existing Ether holdings, representing the investors’ interests in (1) voting on which projects the DAO will fund on its network and (2) collecting returns on successful investments.\textsuperscript{53}

III. FEDERAL COURTS & REGULATORS

Lacking legislative guidance, numerous federal agencies — including the Federal Reserve, Internal Revenue Service, Financial Crimes Enforcement Network — and several state legislatures impose their own distinct (and often conflicting) classifications and regulatory frameworks for virtual currencies.\textsuperscript{54} Despite the resulting confusion among investors, regulators, and federal courts, the current regulatory landscape has developed mainly around efforts by securities and commodities regulators to expand their jurisdictional purviews to encompass virtual currencies, crypto-funds, and other related investment vehicles.\textsuperscript{55}


\textsuperscript{52} Laila Metjahic, Note, Deconstructing the DAO: The Need for Legal Recognition and the Application of Securities Laws to Decentralized Organizations, 39 CARDOZO L. REV. 1533, 1542–46, 1544. The DAO initially raised $150 million worth of Ether before hackers found an exploit in its coding protocol and stole $60 million worth of funds, ultimately collapsing the network. While the DAO is no longer operational, it will be used for analysis because its extensive consumer popularity, unique nature, and resulting attention from the SEC provides unparalleled insight into the agency’s legal basis for regulating such networks, ICOs, and virtual currencies overall. See generally, Michael del Castillo, The Developers Behind the DAO Are Launching a New DAO, COINDESK (Nov. 18, 2016), https://www.coindesk.com/dao-developers-launching-new-dao (discussing the collapse of the DAO).

\textsuperscript{53} Id. at 1545–46. The DAO and similar networks are known as “DAOs.” See, e.g., What is a DAO?, BLOCKCHAIN HUB, https://blockchainhub.net/dao-decentralized-autonomous-organization/ (“A DAO (Decentralized Autonomous Network) can be seen as the most complex form of a smart contract . . . ”).


\textsuperscript{55} See Trevor Dodge, SEC and CFTC Chairmen Testify Before Senate on Cryptoasset Regulation, PROSKAUER (Mar. 22, 2018), https://www.blockchainandthelaw.com/2018/03/sec-and-cftc-chairmen-testify-before-senate-on-cryptoasset-
As the primary regulator of U.S. securities markets, the SEC derives its regulatory authority in two main ways. First, in passing the Securities Exchange Act of 1934 — the federal statute which grants the SEC regulatory authority over trading markets, financial reporting obligations, insider trading, and broker conduct — Congress explicitly classified certain financial instruments as securities. Second, the SEC now employs the Supreme Court’s “Howey test” to classify newly emerging financial products as “investment contracts” subject to its oversight, consequently “determin[ing] the purview of its jurisdiction.” Howey’s central inquiry is “whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.” If so, “it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.” In practice, Howey is broken down into four essential elements: (1) an investment of money; (2) an investment in a common enterprise; (3) an expectation of profits from the investment; and (4) profits that are generated solely from the efforts of others.

The SEC maintains that most tokens and all ICOs are securities because they satisfy Howey. In July 2017, the agency released a report regarding regulation.


59. W.J. Howey, 328 U.S. at 301 (internal citations omitted).

60. Id. For the purposes of this Comment, “security” is used to describe a valid “investment contract” under Howey and/or the Exchange Act because, unlike the Commodity Futures Trading Commission (“CFTC”) jurisdiction regarding commodities, all securities fall within SEC jurisdiction. See generally infra Section III.B (discussing CFTC jurisdiction).


its investigation of the DAO where it reported its findings that DAO tokens are securities. In January 2018, SEC Chairman Jay Clayton Giancarlo warned in a multi-agency op-ed concerning DLT products that his agency “will vigorously pursue [ICOs that] seek to evade the registration, disclosure and anti-fraud requirements of our securities laws,” which he believes are wide-spread. Shortly after, the SEC’s Director of Corporate Finance released a statement detailing four central factors that the SEC considers in evaluating a specific token under Howey: whether its issuers (1) play a significant role in developing and maintaining the token and its potential to increase in value; (2) retain an interest so that they have financial incentive to increase its value; (3) raise funds in excess of those needed to launch the platform; and (4) market the tokens to the public as opposed to specific users of the platform.

B. Commodities Futures Trading Commission

As the regulatory agency tasked with oversight of U.S. commodity futures trading, the CFTC derives its jurisdiction from the Commodity Exchange Act (the “CEA”), which Congress enacted in 1936 to regulate “the trading of commodity futures” and establish the “statutory framework under which the CFTC operates.” Section 1(a)(9) of the CEA defines a “commodity” as — in addition to an extensive list of physical products such as wheat, cotton, and rice — “all other goods and articles, except onions . . . and all services, rights, and interests . . . in which contracts for future delivery are...”

(noting SEC Chairman testimony to Congress that he “has not seen an ICO issue a token that is not a security”) (internal quotations omitted).


65. See SEC Thinks Most Tokens Are Securities, supra note 62.


presently or in the future dealt in." In expanding its jurisdiction to emerging products beyond those enumerated in § 1(a)(9) and those that fall outside its statutory authority over price-manipulation of commodities in interstate commerce, the CFTC currently interprets § 1(a)(9) definition as broadly encompassing both assets currently underlying a regulated futures market — usually referred to as a Designated Futures Market ("DCM") — and those capable of doing so in the future. The agency definitively has "exclusive jurisdiction regarding accounts, agreements[,] . . . and transactions involving swaps[,]"; the term "swap" is defined in part as: "any agreement, contract, or transaction— (i) that is a . . . option of any kind . . . [or] (ii) that provides for any purchase, sale, payment, or delivery . . . dependent on . . . a contingency . . . ." The CFTC may also regulate certain "retail commodity transactions," which include, inter alia, "transaction[s] in any commodity that is — entered into with . . . a person that is not an eligible contract participant or eligible commercial entity; and entered into . . . on a leveraged or margined basis . . . .", and exclude certain exceptions under § 2(h)(4). Eligible contract participants” are, inter alia, individuals with discretionary investments of more than $10 million or more than $5 million if the

68. 7 U.S.C. § 1(a)(9) (known as the "Dealt-in Requirement"); see, e.g., Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc., 334 F. Supp. 3d 492, 497 (D. Mass. 2018) ("Congress’ approach to defining ‘commodity’ signals an intent that courts focus on categories—not specific items—when determining whether the ‘dealt in’ requirement is met.").


70. For the purposes of this Comment, assets used as the basis of a DCM are referred to as “DCM-underliers.” See Trading Organizations, U.S. COMMODITY FUTURES TRADING COMMISSION, https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm (last visited Feb. 5, 2019) (defining "DCM" and discussing relevant CFTC compliance standards).


72. 7 U.S.C. §§ 1(a)(47)(A), 2(a)(1)(A); see also SEC, The Regulatory Regime for Security-Based Swaps 3 (2012), http://www.sec.gov/swaps-chart/swaps-chart.pdf (defining derivative swaps as a derivative “in which two counterparties agree to exchange or ‘swap’ payments with each other as a result of such things as changes in a stock price, interest rate or commodity price”).

73. 7 U.S.C. § 2(c)(2)(D)(i).
transactions were intended to manage risk associated with ownership of an asset,74 while “eligible commercial entities” are eligible contract participants who meet additional requirements.75 However, § 2(h)(3) provides that “nothing in this Act shall apply to . . . transaction[s] in an exempt commodity . . . entered into on a principal-to-principal basis solely between persons that are eligible commercial entities . . . and executed or traded on an electronic trading facility.”76

In 2015, the CFTC deemed virtual currencies commodities subject to its jurisdiction under the CEA.77 Despite failing to provide clear guidance, the agency established its view that: (1) virtual currencies are commodities; (2) sales of options on virtual currencies fall within its purview; and (3) virtual currencies are not “real” currencies.78 However, the agency failed to provide much analytical support for its primary finding — that virtual currencies are commodities — arguing only that the CEA’s definition is broad and citing to a single case.79 In late 2017, the CFTC released a primer detailing the agency’s guidance on DLT networks and virtual currencies.80 The primer states that §1(a)(9) properly encompasses “Bitcoin and other virtual currencies,” meaning the CFTC has jurisdiction over cryptocurrencies when they (1) are used in a derivatives contract; or (2) involve fraud or manipulation, so long as they are traded in interstate commerce.81 Notably, the primer warns consumers that online exchanges may not be “subject to the supervision which applies to regulated exchanges,” including those that “engage in only certain spot or cash market transactions and do not utilize margin, leverage, or financing.”82 Referencing The DAO Report, the primer also notes that “[t]here is no inconsistency between the SEC’s analysis and the CFTC’s determination.”83 In November 2018, the CFTC released a second primer regarding DLT networks, this time listing potential legal frameworks which may apply to Smart-contract networks and noting when they may fall within its jurisdiction.84

74. Id. § 1(a)(18)(A)(xi).
75. Id. § 1(a)(17).
76. Id. § 2(h)(3).
77. See Coinflip Order, supra note 14, at 3.
78. Id. at 2–3, n.2; see also infra notes 175–76 and accompanying text (discussing the CFTC’s implied classification of virtual currencies as “exempt commodities”).
79. See Coinflip Order, supra note 14, at 3 (citing Bd. of Trade of City of Chi. v. Sec. & Exch. Comm’n, 677 F.2d 1137, 1142 (7th Cir.) (1982)).
80. See LABCFTC, supra note 11.
81. Id. at 11.
82. Id.
83. Id. at 14.
84. See Primer on Smart Contracts, supra note 32, at 22, 25.
C. CFTC v. McDonnell

In March 2018, the CFTC alleged that a virtual currency trader developed a deceptive scheme to defraud investors by misappropriating their funds under the guise of a legitimate advisor for the trading and purchasing of cryptocurrencies.\(^85\) The resulting case, McDonnell, yielded the first (and so far, only) final judgement, in which a federal court formally recognized the CFTC’s broad classification of virtual currencies as commodities that are subject to the agency’s jurisdiction.\(^86\) Most importantly, the court held that: (1) virtual currencies are commodities subject to CFTC regulation under § 1(a)(9); and (2) the Dodd-Frank Act’s amendments to the CEA permit the CFTC to regulate fraud beyond the sale of futures or derivative contracts, including “fraud related to virtual currencies sold in interstate commerce” under § 6(c)(1).\(^87\)

McDonnell relies exclusively on two forms of factual authority in its reasoning on this issue. First, the court cites Black’s Law Dictionary’s and Merriam Webster’s definitions of “commodity.”\(^88\) Second, it cites two legal commentators, noting their arguments that virtual currencies should be regulated as a commodity “based on [the term’s] common usage, . . . because virtual currencies provide a ‘store of value’, and . . . because they serve as a type of monetary exchange.”\(^89\) The only further support is the court’s


\(^87\) McDonnell, 287 F. Supp. 3d at 213. Though other jurisdictions have challenged McDonnell’s application of § 6(c)(1) to the facts in that case because they did not involve allegations of market manipulation, this issue requires extensive analysis and is beyond the scope of this comment. See, e.g., Commodity Futures Trading Comm’n v. Monex Credit Co., 311 F. Supp. 3d 1173, 1189 (C.D. Cal. 2018) (internal citation omitted) (“[T]he CEA unambiguously forecloses the application of § 6(c)(1) in the absence of actual or potential market manipulation.”). But see id. at 1189 n.12 (noting that the pro se defendant in McDonnell neglected to raise this issue, which may explain why the court did not consider it more closely); Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc., 334 F. Supp. 3d 492, 498 (D. Mass. 2018) (citing McDonnell in rejecting that the CFTC’s § 6(c)(1) anti-fraud authority requires allegations of market manipulation).

\(^88\) McDonnell, 287 F. Supp. 3d at 224 (alteration in original) (internal citations omitted) (“Black’s Law Dictionary defines a commodity as ‘an article of trade or commerce.’ Merriam Webster defines it as ‘[a]n economic good . . . [or] an article of commerce . . . .’

\(^89\) Id. at 224–25; see also id. (quoting Mitchell Prentis, Digital Metal: Regulating Bitcoin As A Commodity, 66 CASE W. RES. L. REV. 609, 626, 628–29 (2015) (“It would make sense for regulators to treat Bitcoin as a commodity. Commodities are generally defined as ‘goods sold in the market with a quality and value uniform throughout the
mention of legislative and judicial expansion of the CEA from its original purpose of overseeing agricultural commodities trading to regulating other goods, services, and interests, including intangible assets.  

Next, McDonnell discusses the CFTC’s own interpretation and expansion of its § 1a(9) jurisdiction before briefly concluding:

Virtual currencies are ‘goods’ exchanged in a market for a uniform quality and value. They fall well-within the common definition of ‘commodity’ as well as the CEA’s definition of ‘commodities’ as ‘all other goods and articles . . . in which contracts for future delivery are presently or in the future dealt in.’

The court then moves directly to the issue of concurrent jurisdiction, which is beyond the scope of this Comment and not discussed here.

D. Other Case Law

Aside from McDonnell, federal regulators have thus far secured favorable rulings only on pre-trial motions. Federal courts have, however, issued ultimate decisions in several cases involving CFTC and SEC jurisdiction over other goods and services. These decisions are highly useful for analyzing virtual currency classification because they involve the very same issues regulators must confront in classifying virtual currencies.

world.” This . . . realistically reflects the economic behavior of Bitcoin users’ . . . . ‘Bitcoin should primarily be considered a commodity because it serves the function of money . . . .’”); id. at 224 (quoting Jeff Currie, *Bullion Bests Bitcoin, Not Bitcoin, Goldman Sachs Top Mind*, Mar. 11, 2014, at 7, https://www.paymentlawadvisor.com/files/2014/01/GoldmanSachs-Bit-Coin.pdf) (“A commodity is any item that ‘accommodates’ . . . the need for a store of value . . . . In contrast, a security is any instrument that is ‘secured’ against something else . . . . [B]itcoin . . . is a commodity and not a currency . . . .”).

90. Id. at 225 (citing United States v. Brooks, 681 F.3d 678, 694 (5th Cir. 2012)); In re Barclays Bank PLC, CFTC Docket No. 15-24, 2015 WL 2445059 (May 20, 2015)).


93. See infra Sections IV.A.2, IV.B, VI (discussing issues with the commodities classification, securities classification, and relevant case law).
1. Securities

Though the SEC and others have applied the Howey decision to legally recognize a broad variety of assets as securities, as discussed, the SEC’s legal victories regarding virtual currency jurisdiction are currently limited to pre-trial rulings. However, the agency has taken significant steps outside of court to expand its reach to virtual currencies, particularly regarding ICOs. In The DAO Report, the agency briefly notes Bitcoin satisfying Howey’s first factor — the investment of money — by citing Tenth Circuit and Texas District Court decisions. The DAO Report entirely disregards Howey’s second factor: the need for “a common enterprise.” This is particularly notable because circuits remain split on whether the SEC must show “horizontal commonality” or “vertical commonality” to satisfy this factor. Some jurisdictions further delineate this factor by requiring that a


95. See, e.g., The DAO Report, supra note 64.


97. Id.; see also Securities Litigation: Jurisdictional Defenses, supra note 61 (discussing the Howey factors).

98. “Horizontal commonality” considers whether investors’ fortunes are tied together by their pooling of assets. See Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (requiring horizontal commonality and defining it as “the tying of each individual investor’s fortunes to the fortunes of the other investors by the pooling of assets”).

99. “Vertical commonality” instead focuses on whether the investors’ gains or losses are inseparable from the effectiveness of the investment’s promoter. SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479 (5th Cir. 1974) (focusing on whether the “fortunes of all investors are inextricably tied to the efficacy” of the investment’s promoter).

100. Compare Revak, 18 F.3d at 87 (noting the Second Circuit’s horizontal commonality requirement and holding that “broad” vertical commonality is insufficient), and Hart v. Pulte Homes of Michigan Corp., 735 F.2d 1001, 1004 (6th Cir. 1984) (describing the Sixth Circuit as “requiring . . . horizontal commonality”), with Long v. Shultz Cattle Co., Inc. 881 F.2d 129, 140 (5th Cir. 1989) (“This court, together with the Ninth and Eleventh Circuits, has explicitly rejected the view that horizontal commonality is a prerequisite . . . within the meaning of Howey and has focused instead on the ‘vertical commonality’ . . . .”), and SEC v. Koscot Interplanetary, Inc., 474 F.2d 473, 479 (5th Cir. 1974) (establishing the Fifth Circuit’s vertical commonality requirement), and SEC v. Glenn W. Turner Enter., Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1973) (noting that the Ninth Circuit requires vertical commonality); see also Ori Oren, ICO’s, DAO’s, and the SEC: A Partnership Solution, 2018 COLUM. BUS. L. REV. 617, 639 (noting outstanding
more specific type of vertical commonality, either “broad” or “strict,” be shown.\textsuperscript{101}

Similarly, the SEC also dismissed the third \textit{Howey} factor — the expectation of profit — with relative ease, simply noting that investors expected an increase in the value of their investments.\textsuperscript{102} The report’s analysis focused almost entirely on arguing that The DAO Report satisfied \textit{Howey}’s fourth factor — the sole efforts of others — because its founder’s efforts were essential to the enterprise, and investor’s voting rights were generally limited.\textsuperscript{103} It also underscores that, despite \textit{Howey}’s original language, courts no longer require that investors expect profits from the “sole efforts of others,” literally, to satisfy the fourth \textit{Howey} factor.\textsuperscript{104} However, while this assertion is technically accurate, circuit courts remain divided on precisely how much effort by others is necessary and how much investor effort is allowable.\textsuperscript{105} Lastly, The DAO Report includes a brief discussion regarding the “foundational principles of the securities laws” and their direct applicability to “capital raising entities making use of [DLT].”\textsuperscript{106}

2. Commodities

As discussed, the Coinflip Order relied largely on \textit{Board of Trade v. SEC}, 677 F.2d 1137, 1142 (7th Cir.),\textsuperscript{107} where the court found that the CEA’s

legal questions and concerns regarding the second \textit{Howey} factor’s applicability to virtual currencies).\textsuperscript{108}

\textsuperscript{101} See Revak, 18 F.3d at 87–88 (2d Cir. 1994) (citing Long \textit{v. Shultz Cattle Co.}, Inc., 881 F.2d 129, 140-41 (5th Cir.1989); Brodt \textit{v. Bache & Co.}, Inc., 595 F.2d 459, 461 (9th Cir.1978)) (“To establish ‘broad vertical commonality,’ the fortunes of the investors need be linked only to the efforts of the promoter. ‘Strict vertical commonality’ requires that the fortunes of investors be tied to the fortunes of the promoter.”) (emphasis in original) (citations omitted); \textit{see generally} Ryan Bomeman, \textit{Why the Common Enterprise Test Lacks a Common Definition}, 5 U.C. DAVIS Bus. L. J. 16 (2005) (discussing jurisdictional splits on the vertical commonality requirement).

\textsuperscript{102} See The DAO Report, supra note 63, at 11–12.

\textsuperscript{103} \textit{Id.} at 12–15.

\textsuperscript{104} \textit{Id.} at 12 (citing SEC \textit{v. Glenn W. Turner Enter., Inc.}, 474 F.2d 476, 482 (9th Cir. 1973); \textit{see also} Tcherepnin \textit{v. Knight}, 389 U.S. 332, 336 (1967) (citing SEC \textit{v. W.J. Howey Co.}, 328 U.S. 293, 298 (1946)) (“[]n searching for the meaning and scope of the word ‘security’ in the Act, form should be disregarded for substance and the emphasis should be on economic reality.”).

\textsuperscript{105} \textit{Compare} Glenn W. Turner \textit{Enter., Inc.}, 474 F.2d at 482 (allowing investors to contribute to sales activities and governance decisions), \textit{with} SEC \textit{v. Life Partners, Inc.}, 102 F.3d 587, 588 (D.C. Cir. 1996) (interpreting the word “solely” to mean “predominantly”).

\textsuperscript{106} See The DAO Report, supra note 63, at 11 (“This definition [of investment contract] embodies a flexible rather than static principle.”).

\textsuperscript{107} See Coinflip Order, supra note 14; \textit{see also} supra note 78 and accompanying text.
definition of commodity includes “literally anything[,] other than onions[,]” underlying a DCM.108 Given the lack of case law directly on point, courts and legal analysts have centrally relied upon a relatively recent line of cases involving the commodities classification as applied to natural gas.109 For example, in United States v. Valencia,110 a defendant charged with commodity-related fraud claimed that, while natural gas traded on the New York Mercantile Exchange (“NYMEX”) is clearly a commodity under the CEA, no futures contracts existed on her firm’s natural gas (West Coast gas), specifically, and therefore it fell outside CFTC jurisdiction.111 However, the District Court rejected these arguments because “natural gas is fungible” and has traded on the NYMEX since 1990.112

Five years later, a defendant argued on appeal in United States v. Futch,113 that the natural gas at issue was not a commodity under the CEA because a clause in the futures contracts traded on NYMEX described them as being “for gas ‘delivered at the Henry Hub, Louisiana’ and the gas in this case was delivered at [another location].”114 As in Valencia, the Fifth Circuit rejected these arguments once more, going as far as labelling them “frivolous.”115

108. See Bd. of Trade v. SEC, 677 F.2d 1137, 1142 (7th Cir. 1982) (citing 7 U.S.C § 2 (1982)).
111. Valencia, 2003 WL 23174749, at *4 (noting the defendants’ argument that, otherwise, “nothing is excluded from CFTC oversight and CEA regulation” because the CEA would be “applicable to any goods capable of being traded on a futures market, even if not currently traded . . . .”); NTA/EV, CME GROUP, https://www.cmegroup.com/company/nymex.html (last visited Feb. 9, 2019) (describing NYMEX as a DCM which offers energy products, metals, and agricultural contracts).
112. Valencia, 2003 WL 23174749 at *8 n.13 (concluding that “[w]hile futures traders apparently do not buy and sell West Coast natural gas on the NYMEX, there is no evidence that West Coast gas could not in the future be traded on a futures exchange.”).
113. United States v. Futch, 278 F. App’x 387 (5th Cir. 2008).
114. Id. at 395.
115. See id. (“Henry Hub is the nexus of several major gas pipelines [and the clause defendant cited] merely specifies the location for gas delivery and does not in any way limit the type of commodity in question, natural gas.”)).
Four years later, that court again cited *Futch* in rejecting the same argument and essentially solidifying the CFTC’s regulatory jurisdiction over natural gas transactions in *United States v. Brooks*.116 Supporting its holding with three reasons, the court first underscored that “natural gas may be moved . . . to Henry Hub[,] . . . [t]hus it would be peculiar that natural gas . . . is not a commodity, but suddenly becomes [one when] it passes through Henry Hub, and ceases to be [one] once it moves [elsewhere].”117 The court then noted that the CEA’s inclusion of an exemption for certain commodities, known as “exempt commodities,” supports its holding because, otherwise, such an exemption would be unnecessary.118 Finally, the decision concludes by noting that prior case law did not support that gas at hubs other than Henry Hub is outside the CEA’s purview despite failing to confront the issue, specifically.119 Notably, courts have also limited the CFTC’s jurisdiction over commodities in interstate commerce under CEA § 1a(19), holding that the provision does not apply to cash forwards, cash transactions, and spot transactions.120

IV. ARE VIRTUAL CURRENCIES COMMODITIES?

To demonstrate that the CFTC’s classification of all virtual currencies as commodities lacks a substantial legal basis, this section analyzes the commodities classification and its impact on CFTC jurisdiction over virtual currency transactions.

A. Bitcoin is a Commodity

Given that the Bitcoin Network’s attributes clearly satisfy the statutory

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116. See *United States v. Brooks*, 681 F.3d 678, 693–94 (5th Cir. 2012) (citing *United States v. Futch*, 278 F. App’x 387, 392 (5th Cir. 2008)).

117. *Id.* at 694–95.

118. *Id.* at 695. Notably, in rejecting a different (but related) claim in regarding exempt commodities, which will not be discussed here, *Brooks* cited reasoning from *Futch*, which was later overturned. *Id.*

119. *Id.* (citing *United States v. Futch*, 278 F. App’x 387, 390 (5th Cir. 2008); *United States v. Valencia*, 394 F.3d 352, 353 (5th Cir. 2004); *United States v. Radley*, 659 F. Supp. 2d 803, 806 (S.D. Tex. 2009); *Commodity Futures Trading Comm’n v. Reed*, 481 F. Supp. 2d 1190, 1195 (D. Colo. 2007); *Commodity Futures Trading Comm’n v. Atha*, 420 F. Supp. 2d 1373, 1377 (N.D. Ga. 2006); *Commodity Futures Trading Comm’n v. Bradly*, 408 F. Supp. 2d 1214, 1220 (N.D. Okla. 2005); *Commodity Futures Trading Comm’n v. Johnson*, 408 F. Supp. 2d 259, 264 (S.D. Tex. 2005)). For the purposes of this comment, these cases are collectively referred to as the “Natural Gas Cases.”

120. See, *United States v. Reliant Energy Servs., Inc.*, 420 F. Supp. 2d 1043, 1062 (“The definition of ‘future delivery’ expressly excludes ‘any sale of any cash commodity for deferred shipment or delivery.’ This is known as the ‘cash forward’ exclusion . . . . [C]ourts . . . have never doubted that § 4 does not apply to transactions in cash or spot markets.”) (internal citations omitted).
definition of commodity as broadly interpreted by courts and regulators, Bitcoins are likely commodities subject to CFTC regulation.

1. Commodities Exchange Act § 1a(9)

Under the CFTC’s own interpretation of CEA § 1a(9), Bitcoin is a commodity and falls within the agency’s jurisdiction.121 Because § 1a(9) does not specifically enumerate the term “virtual currency” or any of its subsets, to be classified as commodities, blockchain networks must fall within the CEA’s jurisdiction over “all other goods and articles, except onions . . . and all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in.”122 As discussed, the CFTC interprets its statutory jurisdiction to mean that any asset underlying a DCM is consequently a commodity.123 Assuming that, when held by private investors, Bitcoin falls within one of these prescribed product categories, it is well-within this reading of § 1a(9) commodity definition simply because it underlies a DCM.124

2. Case Law

The CFTC’s interpretation of § 1(a)(9) commodity definition regarding DCM-underliers is also well-supported by case law. In Board of Trade of Chicago, which remains good law, the Seventh Circuit held that “literally anything other than onions could become a ‘commodity’ . . . simply by its futures being traded on some exchange.”125 Though that decision was ultimately vacated by the Supreme Court for mootness, the Natural Gas Cases confronted the very same issue regarding natural gas and held that it is a commodity simply based on its DCM-underlier status, as discussed above.126 Accordingly, CFTC actions and relevant case law strongly support that § 1(a)(9) grants the CFTC regulatory jurisdiction over Bitcoin simply because it is currently a DCM-underlier.


122. Id.; see also Aron & Jones, supra note 71, at Section II.A (underscoring that cryptocurrencies must fall within the second prong of 7 U.S.C. § 1a(9) to be commodities).

123. See Statement of the Commission, supra note 71.

124. See McCrank, supra note 49; see also Aron & Jones, supra note 71, at Section IV.A (“Because the CFTC’s futures jurisdiction keys off of the sale of a ‘commodity’ (for future delivery) and the word ‘commodity’ is defined in 7 U.S.C. § 1a(9) in terms of futures on the thing in question being dealt in, the [CFTC] has jurisdiction over cryptocurrency futures from the moment they were dealt in.”).

125. 677 F.2d at 1142.

126. See Bd. of Trade of Chic. v. SEC, 459 U.S. 1026 (1982); see also Natural Gas Cases, supra note 119.
B. But CFTC Jurisdiction Stops There — The Dealt-in Requirement

When distinctions in the technical attributes of virtual currencies and the numerous unsettled questions fundamental to establishing CFTC jurisdiction over virtual currencies are accurately considered, the agency’s regulatory authority under § 1(a)(9) currently encompasses only Bitcoin and, regardless, can never include networks that cannot serve as DCM-underliers sometime in the future. The Natural Gas Cases perfectly demonstrate the fundamental concern here: what exactly does the Dealt-in Requirement — “presently or in the future dealt in” — mean? Definitive precedent on this issue is essential to accurately classifying virtual currencies as commodities because, currently, Bitcoin is the only network that underlies a DCM. Accordingly, when practically applied to virtual currencies, this question actually requires two separate, equally important inquiries: (1) whether § 1a(9) commodity definition requires that the product already underlies a DCM, or that it is simply capable of doing so in the future; and (2) whether § 1(a)(9) commodity definition is general and categorical rather than product-specific. Most importantly, the former inquiry — as well as an affirmative answer to the latter — raises a third inquiry, which is of central concern to this Comment: whether “virtual currency” may serve as a product category of commodities under § 1a(9).

127. See supra note 68 and accompanying text (citing the Deal-in Requirement).
128. See David L. Beam et al., Court Finds That Virtual Currency Is a Commodity For the Time Being, Legal Update, MAYER BROWN LLP (Nov. 5 2018), https://www.mayerbrown.com/court-finds-that-virtual-currency-is-a-commodity-for-the-time-being-11-05-2018/ (reporting on My Big Coin’s consideration and broad application of the CEA’s commodity definition); Natural Gas Cases, supra note 119 (noting ambiguities of the CEA’s commodity definition and interpreting it broadly). See generally, 7 U.S.C. § 1a.
129. See McCrank, supra note 49.
131. See, e.g., United States v. Futch, 278 F. App’x 387 (5th Cir. 2008) (considering whether 7 U.S.C. § 1a(9) applies only to specific products or to general product classes, and whether a natural gas product class sufficient for broad commodity status existed there); see also My Big Coin Pay, Inc., 334 F. Supp. 3d at 496–98 (agreeing with the CFTC’s position that the CEA’s commodity definition is general and categorical by citing its explicit reference to “livestock,” which does not enumerate any particular species of animal). But see Beam et al., supra note 127 (concluding that “it remains to be seen how persuasive other court’s find [My Big Coin]’s holding” given the lesser standard imposed on pre-trial motions).
132. See My Big Coin Pay, Inc., 334 F. Supp. 3d at 492 (reading 7 U.S.C. § 1a(9) broadly before considering whether the network at issue was of the same product class
1. "Can Be" or "Are Being?"

While regulators continue their long-standing efforts to resolve these questions definitively, courts remain divided. For example, despite Board of Trade’s sweeping language that anything (other than onions) can be a commodity simply by underlying a DCM, the court exclusively focused on the SEC’s concession that — under the CEA’s definition — the product at issue “became a commodity when the Board of Trade began trading [its] futures.” However, the court failed to explicitly clarify whether an underlying asset could be a commodity without underlying an active DCM. Notably, a literal reading of the court’s language — that commodity status is enabled “simply by its futures being traded” — as well as its ultimate finding regarding the product at issue, as noted above, could only support the conclusion that Board of Trade requires that an active DCM already exists.

Contrarily, the Southern District of Texas held in Valencia that the CEA’s commodities definition “includes goods that can be the subject of futures contracts.” There, however, the court failed to provide a test (or even mere guidance) for making this determination regarding non-traditional and/or emerging products, thereby leaving open a substantial gap in Valencia’s practical applicability to virtual currencies. Primarily, the decision sheds no light on whether an existing DCM for one network is sufficient to regulate others as commodities and, if so, how to deal with networks that can never underly a DCM. Moreover, given that virtually anything with monetary value “can be the subject of futures contracts,” Valencia essentially

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133. Bd. of Trade v. SEC, 677 F.2d 1137, 1143 (7th Cir. 1982) (emphasis added).
134. See Aron & Jones, supra note 71, at 4. Board of Trade, therefore, should be read narrowly as establishing that existing DCM-underlier status enables commodity classification under the CEA. 677 F.2d at 1142–43.
136. See Aron & Jones, supra note 71, at 4 (citing United States v. Valencia, 394 F.3d 352 (5th Cir. 2004)) (emphasis in original).
137. See id.
138. DCM-underlier status requires monetary value, excluding certain networks. Underlying Asset, INVESTOPEDIA, https://www.investopedia.com/terms/u/underlying-asset.asp (last visited Sept. 7, 2018) (“Underlying assets give derivatives their value . . . [and are] used to determine the value of the option up till expiration. The value of the underlying asset may change . . . affecting the value of the option . . . . The price of an option or futures contract is derived from the price of an underlying asset . . . . ”); see also KSI Technology Stack, supra note 46 (discussing KSI, which has no monetary value and therefore could never be a DCM-underlier).
extends CFTC jurisdiction to all products with monetary value. But had Congress intended to grant the CFTC such broad authority, why did it not simply say so and avoid the much more nuanced (and clearly controversial) language: “presently or in the future dealt in?”

_Futch_ provides even less clarity here because the decision focused entirely on the fact that a DCM on natural gas already existed (and on the defendant’s prior admission of this in pre-trial pleadings) to deem it a commodity. Similar to _Board of Trade_, a prima facie reading of the _Futch_ decision could only support that the DCM market must already exist to enable the underlying asset’s commodity status. _Brooks_ was the most clear, stating explicitly (in dicta) that “whether the CEA requires a commodity to be the subject of a currently existing futures market” remains an open question.

Therefore, while Bitcoin’s commodity classification, specifically, remains well-founded under _Board of Trade_, _Valencia_, _Futch_, and _Brooks_, the CFTC has no present legal basis for extending this classification to other virtual currencies.

2. _General or Specific?_

Notably, however, the Natural Gas Cases appear to definitively establish that § 1(a)(9) commodity definition is general and categorical rather than product-specific. For example, as discussed, _Valencia_ held that the natural gas at issue was a commodity within CFTC jurisdiction because “natural gas is fungible,” clearly indicating the court’s view that a particular good’s DCM-underlier status on any U.S. futures market is sufficient to deem it a commodity under § 1(a)(9). The court in _Futch_ deemed the defendant’s natural gas a commodity subject to CFTC oversight under the exact same reasoning, going as far as labelling the defendant’s arguments “frivolous.” And as _Brooks_ concluded in deeming the gas there a commodity, finding derivatives rely on an underlying asset’s value).

140. See also infra notes 204–08 and accompanying text (noting dramatic practical consequences of _McDonnell_, all of which also apply to _Valencia_).

141. United States v. Futch, 278 F. App’x 387, 395 (5th Cir. 2008).

142. _Id._


144. See Natural Gas Cases, _supra_ note 119. But see Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc., 334 F. Supp. 3d 492, 494 (D. Mass. 2018) (denying defendant’s motion to dismiss and agreeing with the CFTC’s position that Bitcoin futures enable broad virtual currency regulation because “Congress’s approach to defining ‘commodity’ signals an intent that courts focus on categories — not specific items.”).


146. _Futch_, 278 F. App’x at 395.
otherwise would have the absurd effect of changing the commodity status of natural gas as it travelled through a pipeline hub specified in a futures contract.147

3. Is “Virtual Currency” a Product Category?

While Bitcoin is a commodity under subject to CFTC oversight CEA § 1a(9), this jurisdiction does not axiomatically extend from Bitcoin to any (let alone all) other virtual currencies because it fails to meet both essential requirements for doing so, as enumerated by federal courts.148 Fundamentally, while one virtual currency presently underlies a DCM (thereby satisfying the first requirement), the second requirement — “fungibility,”149 — simply cannot, as a factual matter, apply to virtual currencies more broadly.150 The most relevant case law on point involved natural gas — a product that (like all other presently recognized commodities) is generally consistent in composition, potential uses, transferability, availability, and investment-earning potential.151 As those cases specifically emphasized as controlling in their reasoning, the “actual nature” of natural gas does not change based on who extracts, uses, or sells, and where they are doing so.152 In direct contrast, many virtual currencies are entirely distinct from one another by their very nature, varying drastically in coding protocol and, consequently, in potential end-uses, transferability,

147. United States v. Brooks, 681 F.3d 678 (5th Cir. 2012) (internal citations omitted).
148. See Valencia, 2003 WL 23174749 at *1, 4 (holding that natural gas is a commodity because at least some of it underlies a DCM and, by its very nature, natural gas is a fungible good); Natural Gas Cases, supra note 119 (finding the same).
150. See supra Section II.C (noting distinctions between popular networks).
151. See Valencia, 2003 WL 23174749 at *8 (articulating, first, the meaning of “fungible,” which natural gas clearly is); see also Legal Alert: Virtual Currencies as Commodities CFTC Wins Battle in the Fight to Define Cryptocurrencies as Commodities but Has it Won the War?, EVERSHEDS SUTHERLAND (Oct. 2, 2018), https://us.eversheds-sutherland.com/NewsCommentary/Legal-Alerts/214772/Legal-Alert-Virtual-currencies-as-commoditiesCFTC-wins-battle-in-the-fight-to-define-cryptocurrencies-as-commodities-but-has-it-won-the-war (“A finding that ‘gas is gas’ as a commodity category may not be an appropriate analogy when applied to all crypto-asset tokens that do not have characteristics that are common with Bitcoin.”) [hereinafter Virtual Currencies as Commodities].
152. See Commodities Futures Trading Comm’n v. McDonnell, 287 F. Supp. 3d 213, 227 (E.D.N.Y. 2018) (citing United States v. Brooks, 681 F.3d 678, 694–95 (5th Cir. 2012) (“[I]t would be peculiar that natural gas at another hub is not a commodity, but suddenly becomes a commodity solely on the basis that it passes through [a hub], and ceases to be a commodity once it moves onto some other locale . . . . [T]he actual nature of the ‘good’ does not change.”)); United States v. Futch, 278 F. App’x 387, 395 (5th Cir. 2008); Valencia, 2003 WL 23174749 at *26–28.
accessibility, and investment-earning potential.153 Moreover, Bitcoin is currently the only virtual currency that serves as a DCM-underlier, which can (as a result) be directly regulated under CEA § 1a(9).154 Accordingly, the CFTC’s basis for deeming Bitcoin a commodity — its DCM-underlier status — does not broadly extend to other entirely distinct networks simply because they fall under the incredibly broad “virtual currency” umbrella.155

Even assuming that (1) the mere possibility of a virtual currency underlying a DCM in the future — i.e. it has monetary value — is sufficient for commodity status, and (2) “virtual currency” is an acceptable product category, several networks could still never be commodities within § 1(a)(9) definition.156 The most demonstrative examples mentioned in this Comment are KSI, R3, and other information blockchain networks that, by design, could never underly a DCM (or any other derivative, for that matter).157 Unlike Bitcoin-class, Smart-contract, and Ripple-class networks, information blockchains are neither convertible nor freely-transferable, and therefore have no real-world value, either monetary or otherwise.158 Given that the very existence and value of a derivative fundamentally relies on an underlying-asset’s real-word monetary value, information blockchains are

153. See, e.g., Harm, supra note 33, at 3–6 (explaining coding protocol and end-use distinctions between Bitcoin and Ethereum). Though My Big Coin found otherwise, it considered a motion to dismiss and was therefore required to accept the CFTC’s factual allegation — that Bitcoin and the network at issue are fungible — as true. Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc., 334 F. Supp. 3d 492 (D. Mass. 2018); see also Virtual Currencies as Commodities, supra note 151 (noting My Big Coin’s standard of review, and that “the definition of virtual currency that it relied on was provided ‘[f]or the purposes of the complaint at issue.’) (alteration in original).

154. See supra Section IV.A.

155. See Mason v. Mach. Zone, Inc., 140 F. Supp. 3d 457, 460 (D. Md. 2015) (defining “virtual currency”); see also Virtual Currencies as Commodities, supra note 151 (“When it comes to the thousand or more different crypto-asset tokens in circulation, it is not so clear that they all function . . . in the nature and category of Bitcoin.”); cf. David L. Beam et al., Court Finds That Virtual Currency Is A Commodity For The Time Being, MAYER BROWN (Nov. 12, 2018), https://www.mondaq.com/unitedstates/x/753430/Commodities+Derivatives+Stock+Exchanges/Court+Finds+That+Virtual+Currenc+y+Is+a+CommodityFor+the+Time+Being (discussing an additional question outside the scope of this comment that even if all virtual currencies were in fact fungible would CME’s delisting of Bitcoin futures, thereby removing its DCM-underlier status, mean that Bitcoin and all other virtual currencies are no longer commodities).

156. See Sec. Indus. & Fin. Mkts. Ass’n v. CFTC, 67 F. Supp. 3d 373, 385 (D.D.C. 2014) (internal citation omitted) (“Derivatives are types of ‘contracts deriving their value from underlying assets.’”).

157. See KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3); see also Mason v. Mach. Zone, Inc., 140 F. Supp. 3d 457, 465 (D. Md. 2015) (involving an in-game currency which cannot be used or transferred outside of a virtual casino).

158. Id.
simply unusable as DCM-underliers. Accordingly, certain virtual currencies are not—and will never be—commodities. Moreover, while technically possible, using asset-backed networks like Tether as DCM-underliers is outright illogical. Their value correlates directly to that of an underlying asset (which can itself simply serve as the DCM-underlier) while providing only greater liability, including added transaction costs and risks of a default or cyber-intrusion, for example.

C. Does It Even Matter?

Because the CFTC enjoys broad oversight jurisdiction over futures, swaps, and other derivatives, it may regulate virtual currency derivatives regardless of their commodity status. Contrarily, certain provisions in the CEA grant the CFTC authority over commodities more broadly and thus rely specifically on a virtual currency’s commodity status to regulate it.

1. Futures & Swaps

The CFTC has relatively broad regulatory authority over all transactions involving futures, swaps, and other financial derivatives under CEA § 4, which grants the CFTC jurisdiction over “transactions in ‘contract[s] for the purchase or sale of a commodity for future delivery.’” Accordingly, if a virtual currency transaction involves a futures contract, the CFTC can regulate it regardless of whether that particular network is a commodity under §1a(9). However, one notable exception is the CEA’s explicit exclusion of cash forwards and cash or spot transactions from § 4 jurisdiction. Accordingly, where any such transaction involves a virtual

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159. See Underlying Asset, supra note 138 (“Underlying assets give derivatives their value . . . [and are] used to determine the value of the option up till expiration. The value of the underlying asset may change . . . affecting the value of the option . . . . The price of an option or futures contract is derived from the price of an underlying asset . . . ”).

160. E.g., Primer on Smart Contracts, supra note 34, at 28–30 (listing risks of Smart-contract networks, including insider manipulation, software vulnerabilities, human error in coding protocols, and technology failures such as internet connectivity, computer stability, and interface compatibility); Castillo, supra note 52 (discussing the collapse of The DAO).


162. United States v. Reliant Energy Servs., Inc., 420 F. Supp. 2d 1043, 1062 (N.D. Cal. 2006); see also id. (noting that Section 4 of the CEA is “exclusively concerned with futures contracts.”).


currency, the CEA can never assert § 4 jurisdiction — even where a corresponding DCM market exists.165

Swap transactions involving virtual currencies already fall within the CFTC’s jurisdiction regardless of whether they are § 1a(9) commodities.166 Given that the CEA’s jurisdictional grant of swap authority makes no mention of reliance on the underlying asset’s commodity status, all swaps involving virtual currencies fall within the CFTC’s jurisdiction.167 Accordingly, a virtual currency’s commodity status is irrelevant to the CFTC’s swap jurisdiction over it.168

2. Interstate Commerce Jurisdiction

Certain CEA provisions grant the CFTC regulatory authority only when the transaction involves a commodity and are therefore the most relevant to virtual currency regulation.169 Arguably, the most significant role § 1a(9) commodity status has in determining CFTC regulatory authority over virtual currencies under CEA § 13(a)(2), which grants the CFTC broad enforcement power over cases involving price manipulation of any commodity in interstate commerce.170 This authority is also well-supported by case law, some of which has even expanded § 13(a)(2) to an arguably unreasonable degree.171 Because § 13(a)(2) jurisdiction fundamentally relies on a

165. Of course, in such a case, and notwithstanding additional complications, the CFTC would likely have an incredibly strong claim to § 1a(9) jurisdiction and could avoid § 4 entirely. See supra Section IV.A.1.

166. See §§ 1a(47)(A), 2(a)(1)(A).

167. See Aron & Jones, supra note 71, at 6 (providing and analyzing examples of language in the 7 U.S.C. § 1a(47)(A) that disregards an underlying asset’s commodity status for CFTC swap jurisdiction); 7 U.S.C. § 2(a)(1)(A) (underscoring the CFTC’s swap jurisdiction over all virtual currency swaps).

168. § 2(a)(1)(A); See Aron & Jones, supra note 71, at 6.


170. See Reliant Energy Servs., Inc., 420 F. Supp. 2d at 1062 (“Although certain provisions of the CEA are concerned exclusively with transactions in futures . . . other provisions, including those dealing with price manipulation, are not so limited in scope.”) (internal citation omitted); 7 U.S.C. § 2(b) (“[A] transaction in respect to any article shall be considered to be in interstate commerce if such article is . . . sent from one State, with the expectation that they will end their transit, after purchase, in another . . . .”).

commodity’s presence in interstate commerce, and most (if not all) virtual currencies rely on internet connectivity for transferability, deeming a particular virtual currency a § 1a(9) commodity would allow the CFTC to bring enforcement actions in cases with alleged price manipulation and — if the current trend of expanding § 13(a)(2) beyond price manipulation continues — potentially even those without it.

3. Retail Jurisdiction & Exempt Commodities

Classifying virtual currencies as commodities would extend CFTC jurisdiction to leveraged or margined retail transactions not involving eligible contract participants or commercial entities, barring any exceptions under § 2(h)(4). However, the Coinflip Order strongly implies the agency will treat virtual currencies as “exempt commodities” because it considered whether offerings at issue satisfied the Trade Option exemption under CFTC Rule 32.3 (which applies only to exempt commodities), and not as “excluded commodities” (which include currencies and exchange rates) because it stated that virtual currencies are not “real currency.” Most notable here is that this classification would preclude CFTC jurisdiction in certain situations unless it asserts that jurisdiction under § 1(a)(9) because,

Monex Credit Co., 311 F. Supp. 3d 1173, 1189 (C.D. Cal. 2018) (arguing that McDonnell erroneously applied § 6(c)(1), which “the CEA unambiguously forecloses... in the absence of actual or potential market manipulation” and finding that “the only plausible interpretation of the Dodd-Frank amendments mandates that § 4b alone prohibits fraud and deceptive conduct, [and] § 6(c)(1) prohibits fraud-based manipulation.”).

172. See United States v. Nosal, 676 F.3d 854, 859 (9th Cir. 2012) (citing Computer Fraud & Abuse Act (“CFAA”), 18 U.S.C. § 1030(e)(2) (2012)) (holding that the CFAA’s statutory definition of computers as those “used in or affecting interstate foreign commerce” includes any computers connected to the world wide web).


175. See 7 U.S.C. § 1a(20) (defining “exempt commodity” as one that is not an “excluded” or agricultural commodity).

176. See id. § 1a(19) (defining “excluded commodity” as an interest rate, exchange rate, or currency, inter alia).

177. In re Coinflip, Inc., CFTC Docket No. 15-29, at *1, 2 n.2 (Sept. 17, 2015); see also Frequently Asked Questions on Virtual Currency and CFTC Jurisdiction, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP 1, 3 (2017), https://www.skadden.com/insights/publications/2017/11/faqs-on-virtual-currency-and-cftc-jurisdiction (discussing the CFTC’s implied classification of virtual currencies as exempt as opposed to excluded commodities); Editor, Show Me the Money, 35 No. 11 FUTURES & DERIVATIVES L. REP. 1, 1 (2015) (arguing that the Coinflip Order demonstrates the CFTC’s placing virtual currencies “in the same regulatory category as precious metals rather than as legal tender currencies or financial instruments”).
as discussed, § 2(h)(3) specifically excludes transactions in exempt commodities entered into directly between eligible commercial entities and executed through an electronic trade facility. Accordingly, so long as a virtual currency transaction is entered into by such entities, does not involve an indirect transaction — such as one involving financial derivative, for example — and is executed on an electronic trading facility, its exempt commodity classification excludes it from CFTC jurisdiction.

V. WHY MCDONNELL GOT IT WRONG

The central issues with McDonnell’s holding — that all virtual currencies are commodities subject to CFTC jurisdiction — appear to result entirely from the court’s (understandably) weak comprehension of an emerging technology, its nuances, and relevant technical definitions. Specifically, McDonnell’s holding is erroneous because the court (1) relied on and misapplied inadequate factual authorities that failed to account for nuances important to regulatory classification, and (2) oversimplified, and thereby misinterpreted, case law regarding commodities regulation more broadly.

A. Misapplied Facts

1. Erroneous Reliance on Dictionary Definitions

Due to its reliance on insufficient factual authorities that provide broad definitions of important technical terms, McDonnell overgeneralized and misapplied the facts at issue as well as the definition and scope of the term “virtual currency.” First and most concerning is the court’s reliance on factual sources that, while certainly reliable, were clearly neither intended nor claimed to account for the specific nuances of virtual currencies or provide the in-depth understanding of these products required for an accurate legal analysis and regulatory classification of any emerging technological product. Rather than sufficiently identify the precise facts, terms, and technical distinctions at issue, the court relied on just two sources: one classified as a “general-purpose dictionary,” designed to provide a “complete inventory of a language” and word-use, and another designed to “provide...
definitions of words in their legal sense,” rather than serve as factual bases for properly understanding the actual nature of complex new technologies.  

Therefore, while a court may certainly employ dictionaries and similar sources for determining precise definitions to operative terms in cases involving complex financial and technological products (just as this Comment does in the following section), these operative terms must first be identified and properly contextualized by reference to more topic-specific sources with specialized, in-depth knowledge of the issue at hand (such as a treatise, for example).

Moreover, the court’s reliance on dictionary definitions is misplaced because the court erroneously overgeneralizes all virtual currencies as “articles of trade or commerce” or “economic goods.” While certain virtual currencies like Bitcoin-class, Smart-contract, and Ripple-class networks are well-within these definitions because they are convertible, others like information blockchains are not. Following McDonnell’s own reasoning by applying Black’s Law Dictionary’s definitions, information blockchains are not articles of “trade” or “commerce” because they do not involve barters, purchases, sales, or exchanges in any form, between individuals or otherwise. Nor are they “economic goods” under Merriam Webster’s definition because they cannot “be paid for,” as it explicitly requires. Moreover, employing these definitions as a legal basis for regulating a novel, complex product is generally concerning because, in

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184. See infra note 212.


186. See KEY DEFINITIONS, supra note 2, at 4 (defining convertible currencies); KSI Technology Stack, supra note 46 (discussing KSI).

187. See Trade, BLACK’S LAW DICTIONARY (10th ed. 2014) (defining “trade” as “[t]he act or business of exchanging commodities by barter; or the business of buying and selling for money; traffic; barter.”); see also Commerce, BLACK’S LAW DICTIONARY (10th ed. 2014) (defining “commerce” as “[i]ntercourse by way of trade and traffic between different peoples or states and the citizens or inhabitants thereof, including not only the purchase, sale, and exchange of commodities, but also the instrumentalities and agencies by which it is promoted and the means and appliances by which it is carried on, and the transportation of persons as well as of goods . . . .”); see also KSI Technology Stack, supra note 46 (discussing KSI).

188. See Economic Good, MERRIAM-WEBSTER (defining an “economic good” as “a commodity or service that is useful to man but that must be paid for — usually used in plural.”), https://www.merriam-webster.com/dictionary/economic%20good (last visited May 15, 2018); KSI Technology Stack, supra note 46 (discussing KSI).
addition to the generalized nature of these sources, Black’s Law Dictionary’s definitions of “commodity” relies on the words “trade” and “commerce,” and vice versa. Accordingly, relying on definitions which depend directly on one another for determining regulatory jurisdiction (or as the primary basis of a federal court opinion on any matter of first impression, for that matter) directly employs circular reasoning and is legally unsound.

2. Misinterpreted Legal Commentary

McDonnell appears to have applied the attributes of just one virtual currency, the Bitcoin Network, to all virtual currencies, generally. This is most apparent in the only reasoning other than the definitions discussed above that the court provides for deeming virtual currencies commodities. McDonnell reasons that virtual currencies should be deemed commodities due to their common usage for monetary exchange and ability to store value. However, the court supports these assumptions exclusively with legal commentary regarding Bitcoin, specifically, rather than all virtual currencies or even the narrower cryptocurrency subset. Even assuming that these commentators are accurate and Bitcoin is a commodity (as is likely the case), the court failed to provide any sound reasoning or legal basis for extending commodity status to virtual currencies, broadly.

Further, McDonnell’s relied-upon legal commentaries that contradict its holding in-part and, regardless, are not sufficiently accurate enough to serve as a factual basis for deciding precedential (and undeniably consequential) legal issues. First, one cited commentator opines that Bitcoin should be regulated as a commodity because the term is “generally defined as ‘goods sold in the market with a quality and value uniform throughout the world’ . . . . [Which] realistically reflects the economic behavior of Bitcoin users.” However, the price of Bitcoin varies dramatically between

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189. See Trade, supra note 186; see also Commerce, supra note 186.


192. Id.

193. Id.

194. Id.

195. Id.

countries and even individual exchanges within one country.\(^{197}\) Therefore, even if \(McDonnell\) had properly distinguished Bitcoin from other virtual currencies, relying exclusively on the cited legal commentary would still yield an inaccurate analysis of the facts at issue.\(^{198}\) Moreover, one commentator defines a commodity as any item that assists with storing value before applying this definition to Bitcoin and then emphasizes that, “in contrast, a security is any instrument that is ‘secured’ against something else.”\(^{199}\) Accordingly, under \(McDonnell\)’s own factual basis, asset-backed tokens like Tether’s USDT, are securities and, in contrast, not commodities.

**B. Misapplied Law**

\(McDonnell\) oversimplified and resultingly misapplied the law regarding the legal commodities classification. Specifically, the court erred in disregarding a central, unresolved question in commodities regulation: does the commodity classification apply only to current DCM-underliers, or to any product capable of underlying a DCM in the future?\(^{200}\) While courts may rationally consider classifying goods with generally fungible characteristics — such as natural gas, for example — as commodities without an established resolution to this question, this approach is entirely implausible when applied to non-fungible products.\(^{201}\) Given that Bitcoin is currently the only virtual currency serving as a DCM-underlier and is thus a commodity under \textit{Board of Trade} and its progeny, this is a particularly fundamental question in virtual currency classification and \(McDonnell\)’s ultimate holding.\(^{202}\) However, as discussed, certain virtual currencies could never serve as a DCM-underlier and are therefore entirely inapplicable to the court’s reasoning.\(^{203}\) Because \(McDonnell\) overlooks this issue, a reasonable assumption is that the court erroneously overgeneralized all virtual currencies as sufficiently similar (if not entirely interchangeable) to regulate

\(197.\) See Pisani \& Haselton, \textit{supra} note 29 and accompanying text.

\(198.\) But see United States v. Brooks, 681 F.3d 678, 694–95 (5th Cir. 2012) (finding that natural gas is still a commodity regardless of its location because “[w]hile the price of that commodity may fluctuate with its location, and the forces of supply and demand at that location, the actual nature of the “good” does not change).


\(200.\) See Brooks, 681 F.3d at 695 n.11.

\(201.\) See discussion cited \textit{infra} Section III.B.3 (underscoring the non-fungible nature of virtual currencies with comparison to natural gas).

\(202.\) See McDonnell, 287 F. Supp. 3d at 224–28 (describing how the court determined that Bitcoin should be considered a commodity because of how users utilize it as money).

\(203.\) See Sec. Indus. \& Fin. Mkts. Ass’n v. CFTC, 67 F. Supp. 3d 373, 385 (D.D.C. 2014); see also \textit{Underlying Asset, supra} note 138 (describing the nature of underlying assets).
all virtual currencies as commodities based on Bitcoin’s DCM-underlier status.

Notably, McDonnell’s sweeping decision presents some surprising, likely unintended legal consequences. For example, given the existence of housing futures and freight-based derivatives, McDonnell’s reasoning theoretically permits CFTC actions against real-estate brokers and shipping companies simply by alleging some form of fraud against their customers. The CFTC could argue that, as DCM-underliers, housing and freight transactions are commodities under § 1a(9), and therefore any fraud involving these commodities is actionable under § 6(c)(1). Moreover, given that McDonnell’s interpretation of § 6(c)(1) removes the requirement of an existing futures contract, the CFTC could rely on its reasoning to bring enforcement actions against any services on which DCM markets exist, such as legal services, for example.

VI. SO, ARE THEY SECURITIES?

Several major cryptocurrencies, as well as DAOs, likely fall well within the legal definition of “security” — or, more precisely, “investment contract” — and thus within the regulatory purview of the SEC regardless of their commodity status. This is because all convertible cryptocurrencies, such as Bitcoin-class and Smart-contract networks, which investors currently employ almost exactly as they do conventional public stocks and other investment vehicles well-within SEC jurisdiction, likely satisfy all four Howey factors. However, applying Howey to other categories of virtual currency requires more nuanced analyses and demonstrates that certain networks — such as information blockchains, for example — are not securities.

Notably, if all virtual currencies, or even just convertible cryptocurrencies, specifically, are categorically deemed securities within SEC jurisdiction,

204. See Brooks, supra note 85.
205. Id.
206. Id.
207. Id.
208. Because the issue of regulating crypto-funds other than the DAO, which function as conventional investment funds while investing in cryptocurrencies, relies on settling the commodities and securities classification issues analyzed here, it is outside the scope of this Comment. See generally Edmund Mokhtarian & Alexander Lindgren, Rise of the Crypto Hedge Fund: Operational Issues and Best Practices for an Emergent Investment Industry, 23 STAN. J.L. BUS. & FIN. 112 (2018) (arguing for a new regulatory scheme for crypto-funds).
209. See White, supra note 28 (describing speculative Bitcoin trading as similar to highly-volatile public stock trading).
DAOs are almost certainly securities as well because they are simply online crowdfunding platforms where, instead of fiat currency and submitted products, investors are employing one convertible cryptocurrency — Ethereum — and one non-convertible cryptocurrency — the DAO token — to fund new projects and determine voting interests in funding emerging cryptocurrency networks.\textsuperscript{210} Congress made it clear in 2012 that online crowdfunding platforms, which issuers use as intermediaries in the offer and sale of securities, are well within SEC jurisdiction in carving out the “Crowdfunding exemption” to the Security Act § 4.\textsuperscript{211}

\textit{A. Investment of Money}

\textit{1. Convertible Cryptocurrencies, Asset-backed Tokens, \& DAOs}

Convertible cryptocurrencies, asset-backed tokens, and DAOs likely satisfy the first \textit{Howey} factor, which requires the “investment of money,” rather easily.\textsuperscript{212} First, many networks and all convertible cryptocurrencies, including asset-backed networks, clearly require an “investment” because (unless gifted) they can only be obtained in exchange for some other property of value.\textsuperscript{213} Second, while still generally clear, one question here arises when users exchange other cryptocurrencies rather than fiat money for tokens: are these other networks “money” as provided in \textit{Howey}?\textsuperscript{214} However, courts have long held that this factor broadly encompasses any

\textsuperscript{210} See generally Metjahic, \textit{supra} note 52 (explaining the DAO).

\textsuperscript{211} See Jumpstart Our Business Startups Act, 17 C.F.R. §§ 200, 227, 232, 293, 240, 249, 269, 274 (2018) (providing “a framework for the regulation of registered funding portals and broker-dealers that issues are required to use as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6) [of the Securities Act].”). \textit{But see} The DAO Report, \textit{supra} note 63, at 4 n.11 (“[The DAO] would not have met the requirements of Regulation Crowdfunding . . . because, among other things, it was not a broker-dealer or a funding portal registered with the SEC and the Financial Industry Regulatory Authority (“FINRA”).”).

\textsuperscript{212} See Securities Litigation: Jurisdictional Defenses, \textit{supra} note 61; \textit{see also} White, \textit{supra} note 28 (describing Bitcoin speculation as similar to trading highly-volatile public stocks).

\textsuperscript{213} See \textit{Investment}, \textit{BLACK’S LAW DICTIONARY} (10th ed. 2014); \textit{see What is Capital, N?}, \textit{BLACK’S LAW DICTIONARY}, (2d ed.) (defining “capital,” “with respect to the property of individuals . . . [as] the property taken from other investments or uses and set apart for an invested in the special business, and in the increase, proceeds, or earnings . . .”); \textit{see also supra} Section I.B (defining “convertible” networks); Section 0-0 (explaining how users can access popular network tokens).

“exchange of value,” and the SEC has already established in court that an investment in Bitcoin is sufficient to satisfy the first prong of Howey. Notably, proponents of Bitcoin-class networks generally support the SEC’s position here because it furthers the legitimacy of the overall cryptocurrency market. DAOs also satisfy the first factor because, just like those in Howey itself, their participants invest personal capital to access them and to ultimately up-start emerging networks.

2. Information Blockchains

Most noteworthy, information blockchains such as KSI and R3 do not satisfy the first Howey factor because their use does not involve an investment of money. These networks do not issue tokens, and their users cannot (lawfully, at least) convert any aspect of the virtual currency network to fiat currency or other asset with real-world value. Courts would therefore need to expand the definition of investment from “any exchange in value” to intangible factors — such as time spent using the network or volume of information exchanged, for example — to extend Howey’s first factor to information blockchains and other networks that do not involve an investment of money.

B. Investment in a Common Enterprise

As mentioned above, the SEC disregards the second Howey factor in The DAO Report entirely, likely because it views DAOs as clearly a “common enterprise” under each of the terms’ various legal standards, as well as its

215. Hocking v. Dubois, 885 F.2d 1449, 1471 (9th Cir. 1989); see also Int’l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of Am. v. Daniel, 439 U.S. 551, 560 n.12 (1979) (stating that an investment may take the form of goods and services).
218. See Metjahic, supra note 52, at 1564 (explaining that investors purchase Ether with fiat-currency and the DAO issues each investor shares based on their individual Ether holdings).
219. See KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3).
220. See KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3).
221. See The DAO Report, supra note 63, at 11 (outlining the SEC’s reasoning).
222. See supra note 98 and accompanying text (describing the circuit split on the definition of “common enterprise”).
common usage. However, this issue is less clearly settled as a legal matter (and, consequently, as applied to virtual currencies) than may first appear, primarily because of the circuit split over whether it requires a showing of horizontal or vertical commonality and, if the latter, whether it must be broad or strict. Second, while less crucial here, it is worth noting that courts hesitate to interpret Howey’s language literally, and instead focus specifically on the “economic reality” of the industry at issue.

1. Convertible Cryptocurrencies & DAOs

Convertible cryptocurrencies likely satisfy horizontal commonality rather easily because their adoption by a user-base investing its personal assets in exchange for tokens is precisely what creates, sustains, and changes their value against fiat currencies, thereby directly tying investors’ fortunes together by their pooling of assets. Further, these networks likely satisfy both broad and narrow vertical commonality inquiries as well because (1) their success and value depend directly on the efficacy of the network’s promoter, and (2) investors’ fortunes are tied to that of the promoter. The Eleventh and Fifth Circuits found that investors relying on promoters’ advertisements of the investments and recruitment of others to gain a greater return was sufficient to show “broad vertical commonality.” Given that investors currently purchase tokens on these networks mainly to profit from

223. See, e.g., Common Enterprise, BUSINESS DICTIONARY http://www.businessdictionary.com/definition/common-enterprise.html (last visited Jan. 15, 2019) (defining “common enterprise” in-part as requiring “common objectives”, which “may be implied by the . . . sharing of profits . . . [or] joint ownership”).

224. See supra notes 97–99 and accompanying text; see also Long v. Shultz Cattle Co., 881 F.2d 129, 140 n.11 (5th Cir. 1989) (“The Supreme Court has thus far declined to resolve this split in authority although three justices expressed a desire to do so.”).


226. See The Bitcoin Phenomenon: How Cryptocurrencies Gain Value, supra note 27 (discussing factors controlling cryptocurrency values); see also Revak v. SEC Reality Corp., 18 F.3d 81, 87 (2d Cir. 1994) (quoting Hart v. Pulte Homes of Mich. Corp., 735 F. 2d 1001, 1004 (6th Cir. 1984) (applying horizontal commonality and defining it as “[y]ielding the fortunes of each investor in a pool . . . to the success of the overall venture . . . [which] requires a sharing or pooling of funds.”) (internal quotation omitted).

227. See supra notes 97–99 and accompanying text (providing the legal standards of broad and narrow vertical commonality).

the appreciation of their value, which in turn relies directly on the developer’s ability to successfully market the product to its intended users, investor’s reliance here is likely sufficient for broad vertical commonality. Moreover, because developers of these networks rely on the exact same factor — the token’s open-market price — to earn a profit, their fortunes are tied directly to that of investors, and therefore these networks likely satisfy strict vertical commonality as well.

DAOs likely satisfy horizontal commonality because, similar to investors in convertible cryptocurrencies, members of these funds invest personal capital for a share of future profits from blockchain ventures successfully funded by their pooled assets. DAOs, however, may not satisfy broad vertical commonality because the success of its members’ investment in the network depends not on the efficacy of the network’s promoter, but rather on the overall success of the blockchain projects successfully funded on network. Accordingly, courts must decide whether only the efficacy of the promoter of a member’s primary investment — Ether purchased to access the DAO, for example — is sufficient to satisfy broad vertical commonality, or whether the efficacy of promoters of the member’s secondary investment — networks crowdfunded on the DAO — may suffice as well. However, such crypto-funds likely satisfy a strict vertical commonality inquiry because, similar to those of convertible cryptocurrencies, developers of DAOs only profit when investors on the network successfully fund a project which generates a return on investment and dividends for those involved.

2. Information Blockchains & Asset-backed Tokens

Information blockchains and asset-backed blockchains do not satisfy Howey’s second factor because, as discussed, tokens on information blockchains have absolutely no monetary value (if they even exist), and the value of tokens on asset-backed networks is derived entirely from the value

229. See Fiorillo, supra note 4 (discussing Bitcoin capital appreciation); Prather, supra note 27 (discussing impacts of market conditions on token values); White, supra note 27 (describing speculative Bitcoin trading); Prather, supra note 28 (discussing impacts of market conditions on token values).


231. See Metjahic, supra note 52 (explaining The DAO).

232. Notably, however, the argument can be made that DAOs do in fact rely on the efficacy of their promoters because, if a promoter fails to attract a sufficient investor pool to join a network, projects could never be successfully funded. See Metjahic, supra note 52 (explaining The DAO).
of an underlying real-word asset. These networks do not satisfy horizontal commonality simply because users do not pool assets and, therefore, their fortunes cannot possibly be tied together by doing so. Similarly, these networks do not satisfy vertical commonality — whether broad or strict — because neither the efficacy nor fortunes of their promoters have any bearing on the investors’ (non-existent) fortunes.

C. Expectation of Profits

Applying Howey’s third factor to virtual currency investments is seemingly straight-forward and, accordingly, receives little attention from regulators and courts. The Supreme Court has provided that the term “profits” in Howey refers specifically to “the profits that investors seek on their investment, not the profits of the scheme in which they invest.” Accordingly, when investors purchase tokens of a particular convertible cryptocurrency with the intention of earning a return on those tokens when their value increases, their expectation of profit is sufficient to satisfy Howey’s third prong. And given that most investors currently purchase tokens on convertible cryptocurrency networks specifically for this purpose, these networks likely satisfy Howey’s third prong. Likewise, DAOs and all other crypto-funds satisfy Howey’s third prong because, similar to any other venture capital or investment fund, members explicitly join these ventures to profit on their investments.

Notably, however, this Howey factor’s applicability to convertible cryptocurrencies may present regulators with one particular issue because, in addition to speculative trading, convertible cryptocurrencies are often used simply to transfer payments for goods or services without any expectation of profit or return on investment. There, users are induced to purchase tokens

233. See KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3).
234. See Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994); KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3).
235. See Fersht, supra note 47 (discussing information blockchains); see also The R3 Story, supra note 47.
236. See The DAO Report, supra note 63; see also Oren, supra note 99, at 639 (only briefly discussing the third Howey factor).
237. SEC v. Edwards, 540 U.S. 389, 394 (2004) (“We used ‘profits’ in the sense of income or return, to include, for example, dividends, other periodic payments, or the increased value of the investment.”).
238. See White, supra note 27 (describing Bitcoin speculation as similar to trading highly-volatile public stocks).
239. See id.
240. See Metjahic, supra note 52 (explaining The DAO).
241. See Fiorillo, supra note 4 (discussing Bitcoin payment-processing).
simply to acquire interests, goods, or services, which the Supreme Court has long held does not invoke the applicability of securities laws.\textsuperscript{242} Contrarily, information blockchains and asset-backed networks clearly do not satisfy this Howey factor because their users have no expectation of profits whatsoever, instead employing these networks to exchange information and to move capital between other virtual networks and one another, respectively.\textsuperscript{243}

\textbf{D. Sole Efforts of Others}

Despite the SEC’s focus on Howey’s fourth factor in The DAO Report, its applicability to virtual currencies appears to be generally straight-forward.\textsuperscript{244} While courts are divided on exactly how much effort investors themselves may exert or others must exert to satisfy this factor, each type of virtual currency discussed thus far with the exception of information blockchains\textsuperscript{245} seems to fall well-within standards which are relatively consistent across jurisdictions.\textsuperscript{246}

1. Asset-backed Tokens & DAOS

This is particularly apparent in applying Howey’s fourth factor to asset-backed tokens because their value may rely directly on the actions of those entirely uninvolved in the network itself, such as a state government (when backed by fiat currency) or a farming collective (when backed by agricultural commodities), for example.\textsuperscript{247} Such tokens are functionally equivalent to derivative securities, such as options — financial instruments that create

\textsuperscript{242} See United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851 (1975) (holding that, despite having the term “stock” in its name, a venture was not a security because “the inducement to purchase was solely to acquire [an interest]; it was not to invest for profit.”).

\textsuperscript{243} See KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3).

\textsuperscript{244} See The DAO Report, supra note 63, at 12–14 (focusing on Howey’s fourth factor by underscoring investors’ limited voting rights and strong reliance on cryptocurrency developers to realize profits). But see Oren, supra note 99, at 642–43 (noting and arguing against the SEC’s attempts to dismiss the fourth Howey factor).

\textsuperscript{245} As discussed, information blockchains have no monetary value and therefore users have no expectation of profits — from the sole efforts of others or otherwise. See supra notes 45–48 and accompanying text (discussing information blockchains).

\textsuperscript{246} Compare SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 477, 482 (allowing investors to contribute to sales activities and governance decisions), with SEC v. Life Partners, Inc., 102 F.3d 587, 588 (D.C. Cir. 1996) (interpreting the word “solely” to mean “predominantly”).

\textsuperscript{247} See KSI Technology Stack, supra note 46 (discussing KSI); The R3 Story, supra note 47 (discussing R3).
contract rights to buy or sell underlying securities at a “strike” price in that they are pegged to the price of underlying assets and therefore “derive their value” from them. Courts widely recognize that options are securities as well as the SEC’s long-held view that “transactions involving derivative securities could be equated to the purchases and sales of the underlying securities for the purposes of incurring liability under [the Securities Act]” because “holding [them] is functionally equivalent to holding the underlying security.” There is therefore no reason to believe that holding security derivatives involves sufficient effort by others to deem them securities, while the same does not apply to asset-backed tokens.

Accordingly, asset-backed tokens almost certainly satisfy Howey’s fourth factor and are well within SEC jurisdiction when based on separately recognized securities.

Likewise, DAOs are similar if not identical to conventional online crowdfunding platforms, which, as discussed, fall within SEC jurisdiction where they are used as an intermediary in the offer and sale of securities. Accordingly, it would appear contrary to Congress’s intent to find that DAOs do not involve sufficient effort by others while other crowdfunding platforms performing exactly the same function do. Moreover, circuit court precedent regarding corporate partnerships strongly suggests that investor interests in projects successfully funded on a DAO satisfy Howey’s fourth factor.

2. Convertible cryptocurrencies

The fourth Howey factor’s applicability to convertible cryptocurrencies


249. Magma Power Co. v. Dow Chem. Co., 136 F.3d 316, 321 (2d Cir. 1998); see also id. (holding that the financial instrument at issue, which was pegged to the price of a public stock, was a derivative security); supra notes 41–43 and accompanying text (discussing Asset-backed tokens).


251. While, of course, options are used for price speculation specifically because they require a pre-determined strike price, there is no indication that this is a dispositive factor in their satisfaction of Howey. See Roth, 873 F. Supp. 2d at 530–31 (providing the rationale behind deeming derivatives as falling within SEC jurisdiction).

252. See supra notes 210–11 and accompanying text.

253. SEC v. Merch. Capital, LLC, 483 F.3d 747, 757 (11th Cir. 2007) (distinguishing general partnership interests, which are presumed not to be investment contracts due to the typically active role of general partners in managing the business, from limited partnerships, which leave sufficiently “little power in the hands of the partner”) (internal citation omitted).
appears similarly straight-forward. Just as traditional securities such as common stocks, an investor’s level of control over a token’s price (and therefore overall return) on a convertible cryptocurrencies’ networks varies widely based on their specific ownership status.\textsuperscript{254} Developers can dramatically increase a token’s price by upgrading the network with new capabilities, resolving a previously concerning issue, or promoting the token for a new purpose — functionally equivalent to a corporation releasing a successful new product or announcing a strategic acquisition, for example.\textsuperscript{255} Developers can also impact a token’s price negatively by making changes to the network that are unpopular with users.\textsuperscript{256} Similarly, cryptocurrency “whales” have substantial control over a token’s price — functionally equivalent to the control and influence enjoyed by corporate majority shareholders.\textsuperscript{257} And in both scenarios, average investors with modest holdings — and, in the case of cryptocurrencies, little involvement in the greater community surrounding a network — generate their profits and losses entirely from the sole efforts of others.\textsuperscript{258}

VII. MOVING FORWARD — AN EFFECTIVE (I.E. PRECISE) REGULATORY SCHEME

Fundamentally, McDonnell overgeneralized the function and scope of the term “virtual currency” and extended arguments from legal commentary regarding Bitcoin, specifically, to all virtual currencies, generally.\textsuperscript{259}

\textsuperscript{254} See generally Mark J. Roe, Corporate Law’s Limits, 31 J. LEGAL STUD. 233 (2002) (analyzing discrepancies in stockholder control of day-to-day operations). This issue becomes more complicated, however, when examining networks which allow self-governance. \textit{See, e.g.}, Smith, supra note 35 (discussing Tezos).

\textsuperscript{255} See, e.g., Jacob Sonenshine, SEC Sues Tesla CEO Elon Musk, THESTREET (last updated Set. 27, 2018), https://www.thestreet.com/markets/the-sec-is-suing-elon-musk-14726561 (reporting on the SEC’s suit against Tesla’s CEO for issuing “misleading statements” regarding his securing financing for privatization, resulting in significant stock-price shifts).

\textsuperscript{256} Id.; \textit{EDITORIAL TEAM}, The Howey Test and Cryptocurrency: Which Coins May Apply?, COINBUREAU (May 6, 2018), https://www.coindesk.com/analysis/Howey-test-cryptocurrency/.

\textsuperscript{257} \textit{See EDITORIAL TEAM}, \textit{ supra} note 255 (explaining that because their profits depend on actions, including market-manipulation and network upgrades, by whales and developers).

\textsuperscript{258} \textit{See EDITORIAL TEAM, supra} note 255 (explaining that because their profits depend on actions, including market-manipulation and network upgrades, by whales and developers).

\textsuperscript{259} \textit{See supra} Section IV.A.
Moreover, *McDonnell* misapplied the law by erroneously extending well-established precedent regarding *fungible* goods to a non-fungible field of products while avoiding inconvenient, yet vital legal questions that remain unsettled.\textsuperscript{260} The holding in *McDonnell* that all virtual currencies are commodities subject to CFTC jurisdiction should therefore be narrowed, if not completely overturned, and replaced with case law that accounts for these issues. Perhaps even more significantly, courts must resolve the numerous outstanding legal questions that, while potentially avoidable when dealing with other goods, are essential to determining CFTC jurisdiction over virtual currencies.\textsuperscript{261} These include whether CEA § 1a(9) commodity definition requires present or only potential DCM-underlier status, whether it should be read broadly as a categorical rather than product-specific grant of jurisdiction, and — most importantly — whether “virtual currency” may serve as one such product category under the CEA.\textsuperscript{262}

First, courts should limit CEA § 1a(9) to include only those goods that currently serve as DCM-underliers, aligning with Congress’s original intent in first establishing the CFTC, as well as avoiding the inconceivable practical implications of deeming anything capable of underlying a futures market (or essentially anything with monetary value) a commodity under the CEA.\textsuperscript{263} Second, courts should uniformly establish that CEA § 1a(9) is a categorical definition that encompasses fungible goods, thus enabling the CFTC to regulate fraudulent activity undertaken by those selling products into interstate commerce while aligning with precedent such as the Natural Gas Cases.\textsuperscript{264} Lastly, and as noted repeatedly throughout this Comment, courts should hold that, while Bitcoin is a commodity due to its DCM-underlier status, the term “virtual currency” may not serve as a general product category under § 1a(9) because many networks falling within it are entirely distinct products developed for varying purposes and often countervailing potential uses.\textsuperscript{265}

Similarly, applying *Howey* to categories of virtual currency beyond major cryptocurrencies, DAOs, and other crypto-funds makes clear that certain

\textsuperscript{260} See supra Section IV.B.

\textsuperscript{261} See supra Section III.B.

\textsuperscript{262} Id.

\textsuperscript{263} See 7 U.S.C. § 1a(9) (discussing Congress’s intent and grant of jurisdiction in establishing the CFTC); see also Hunter v. Fed. Energy Regulatory Comm’n, 711 F.3d 155, 157 (D.C. Cir. 2013) (“Congress crafted CEA section 2(a)(1)(A) to give the CFTC exclusive jurisdiction over transactions conducted on futures markets like the NYMEX.”).

\textsuperscript{264} See supra Section II.D.2 (providing factual background on the Natural Gas Cases).

\textsuperscript{265} See supra Sections I.C, III.B, IV.
networks, such as information blockchains, could never be securities under existing case law and requires clarification of outstanding legal questions. Primarily, courts — at this junction, likely the Supreme Court — must uniformly resolve whether an “investment in a common enterprise” may be shown with horizontal commonality, broad vertical commonality, strict vertical commonality, or a different standard entirely. SEC regulators, on the other hand, must confront the central issue concerning the application of securities laws to even the most popular cryptocurrencies when used exclusively to transfer payments for goods or services without any expectation of profit, directly in the face of Supreme Court precedent specifically excluding such transactions in a different context.

Accordingly, perhaps the following regulatory framework, which accounts for the technological attributes of distinct virtual currency networks and agency jurisdiction under existing case law, may be applied in the interim, as demonstrated by Figure 1:

Figure 1:

CONCLUSION

Regulators are often confronted with myriad of newly arising technical nuances, existing legal questions, and long-term practical considerations with innovative new products, goods, and services introduced into the global marketplace and made available to the general public. However, not all (if

266. See supra Section V.
267. See supra notes 88–100 and accompanying text.
268. See United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851 (1975) (holding that securities laws are not invoked when “the inducement to purchase was solely to acquire [an interest]; it was not to invest for profit.”).
any) bring forth as substantial a need for understanding the complex, fundamental technological underpinnings involved as the development of DLT and related financial products such as Bitcoin, Smart-contract networks, information blockchains, and DAOs. McDonnell’s difficulty with identifying the appropriate language and technical distinctions involved in the broad “virtual currency” category is neither condemnable nor surprising; courts are not and cannot possibly be subject-matter experts on even long-standing, let alone newly emerging and highly complex technological innovations that can act as legal contract intermediaries, internal systems of exchange, information recording systems, monetary systems, and — in just one specific application — financial investment products. The McDonnell court was simply doing its job, perhaps too well, in seeking to extend adequate legal protections for consumers to an emerging new field. Likewise, the SEC and CFTC’s attempts to expand their reach beyond existing statutory grants of jurisdiction and case law only further exhibit the tenacity with which regulators seek to fulfill their role of protecting American consumers from fraud and misconduct related to complex financial transactions. However, the outstanding legal questions in commodities law, related defects in McDonnell’s holding, and practical concerns in applying securities law to an innovative new product present regulators and courts with an optimal opportunity to establish an effective, accurate, and precise regulatory framework to govern virtual currencies.
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