

INSIGHTS

The CFTC and Virtual Currencies: Amidst All the Hype, Don't Forget "Commodity" is still a Defined Term

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The Internet recently erupted with news reports and law firm legal alerts broadcasting the endorsement by a federal court of the Commodity Futures Trading Commission's (CFTC) position that virtual currencies (a/k/a cryptocurrencies) are commodities subject to CFTC oversight pursuant to the Commodities Exchange Act (CEA). However, while it is clear that Bitcoin is a commodity for purposes of CFTC jurisdiction, the same may not be true of other virtual currencies.

The CFTC generally has exclusive jurisdiction over commodity derivatives, including futures, options and swaps, but it only has limited, non-exclusive authority with respect to physical commodities. Specifically, the CFTC is empowered to establish and enforce rules that prohibit fraud in connection with any "contract of sale of any commodity in interstate commerce" or manipulation of the price of any such commodity.

In *CFTC v. McDonnell*,^[1] Judge B. Weinstein of the U.S. District Court for the Eastern District of New York found that the "CFTC has standing to exercise its enforcement power over fraud related to virtual currencies sold in interstate commerce." The Court reached this opinion based on two key conclusions:

1. "A 'commodity' encompasses virtual currency both in economic function and in the language of the statute ... (The CEA defines 'commodity' as agricultural products and 'all other goods and articles . . . and all services, rights, and interests . . . *in which contracts for future delivery are presently or in the future dealt in.*') [Title 7 U.S.C. § 1a(9).]" (*emphasis added*)
2. "CFTC's broad authority extends to fraud or manipulation in derivatives markets and *underlying spot markets.*" (*emphasis added*)

While both conclusions are logical as to Bitcoin, which is the interest underlying multiple futures contracts in the United States, both appear inconsistent with any broader maxim that all virtual currencies are commodities subject to CFTC jurisdiction. As to the first conclusion, interpreting virtual currencies to be services, rights or interests only addresses part of the definition of commodity; the sweeping language used by the *McDonnell* Court appears to either ignore, assume or silently interpret out of existence the condition that services, rights and interests are only commodities *if traded as futures*. This concept of a necessary futures contract

is further reinforced by the second conclusion, which references *underlying* spot markets.

Absent a futures contract, the modifier “underlying” is without meaning. As discussed below, the defendants in another pending case, *CFTC v. My Big Coin Pay, Inc.*, currently are challenging this theory in a federal court in Massachusetts.^[2]

Background

Futures on Bitcoin have been offered in the United States since late 2016, and the CFTC has asserted that certain “virtual currency futures trading has also occurred on various boards of trade outside the United States since at least 2015.” The CFTC first asserted jurisdiction over options on Bitcoin in September 2015, summarily concluding in a settlement order that “Bitcoin and other virtual currencies are encompassed in the definition [of commodity] and properly defined as commodities.”^[3] (*emphasis added*) That same month, the CFTC settled a matter involving execution of Bitcoin swaps on a registered swap execution facility.^[4] In June 2016, the CFTC settled another matter involving Bitcoin, citing its two earlier settlements to support the conclusion that “Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities, and are therefore subject as a commodity to applicable provisions of the Act and Regulations.”^[5] Despite the open-ended references to “other virtual currencies,” these and most of the CFTC’s cases to date have involved either derivatives of Bitcoin, fraud with respect to trading Bitcoin, or misappropriation of funds (that happened to be in the form of Bitcoin) with respect to schemes related to other jurisdictional activities.^[6] Importantly, the CFTC has indicated “other” virtual currencies are commodities; it has not claimed that *all* virtual currencies are commodities.

CFTC v. McDonnell

In *McDonnell*, the allegations involve misappropriation of Bitcoin and fraud related to solicitations to trade Bitcoin, but they also include allegations related to solicitations to trade Litecoin – a separate virtual currency. According to the CFTC, “BitMEX, a foreign board of trade with offices in Hong Kong ... offers futures contracts on Bitcoin and Litecoin, among others,” but the *McDonnell* Court did not expressly rely on this fact when making its determination with respect to CFTC jurisdiction.

It is unclear whether the broad comments of the *McDonnell* Court are intended to mean *all* virtual currencies are commodities or only that there are other virtual currencies (beyond Bitcoin) that are commodities. To the extent it is the former, this statement arguably is dicta (unnecessarily broad to decide the facts before the court). Focusing on the facts at issue, and setting aside the rhetoric, *McDonnell* might stand only for the narrow proposition that futures traded on a foreign board of trade can satisfy the futures requirement for the definition of commodity.^[7] We may get another piece to the puzzle in *My Big Coin Pay, Inc.*, where the defense is challenging the CFTC’s claim to jurisdiction over a coin likely not traded on any futures exchange anywhere in the world.

CFTC v. My Big Coin Pay, Inc.

In *My Big Coin Pay, Inc.*, the CFTC is alleging that the defendants violated the CEA by fraudulently offering the sale of a virtual currency in interstate commerce by making false and misleading claims and omissions about the currency’s value, usage, trade status, and backing. The defense has raised a number of challenges, including challenging the CFTC’s application of its anti-manipulation authority to fraud against individuals (as opposed to fraud on the market). Most

relevant here is their claim that, “[p]er the plain language of the CEA, intangible ‘services, rights and interests’ are only included in the CEA’s definition of the term ‘commodity’ if there are futures contracts traded on them.” The defense contends that, because the specific virtual currency at issue is not traded in futures, it is not a commodity pursuant to the CEA.^[8]

Beyond Virtual Currencies

The broad statements in *McDonnell* may stem in part from an eagerness to shape the future of blockchain technology applications and protect consumers who choose to participate in virtual currency markets from fraud. It might be the result of a lack of appreciation for how separate and distinct each virtual currency is as a potential commodity. Or it could be that the statements were only intended to recognize that virtual currency can qualify as a commodity, assuming a futures contract is traded in the currency. Whatever the cause, the effect is not limited to virtual currencies. If the CFTC is permitted jurisdiction over all fraud involving all virtual currencies, independent from any potential impact on a futures contract (or even the existence of a futures contract), what, apart from lack of enthusiasm, stops the CFTC at virtual currency? What keeps the CFTC from applying its anti-fraud rule to any other intangible services, rights or interests with little or no connection to futures markets? Housing futures exist for certain housing markets; does that mean the CFTC can bring a claim against the real estate broker who makes a material misstatement when selling a house? Do freight-based derivatives on a foreign board of trade give the CFTC jurisdiction over any shipping company that commits fraud against its customers? If no futures contract is required at all, what prevents the CFTC from regulating legal services or tax advisers? While these examples are extreme, if the broadest interpretation of *McDonnell* is embraced, courts will need to find a way to contain it.

^[1] *CFTC v. McDonnell*, Case No. 18-cv-0361, Dkt. 29 (E.D.N.Y. Filed Jan 18, 2018).

^[2] *CFTC v. My Big Coin Pay, Inc.*, Case No. 1:18-cv-10077 (D. Mass. Filed Jan. 16, 2018).

^[3] *In re Coinflip Inc.*, CFTC Docket No. 15-29 (Sept. 17, 2015).

^[4] *In re TeraExchange, LLC*, CFTC Docket No.15-33 (Sept. 24, 2015)

^[5] *In re BXFNA Inc.*, CFTC Docket No. 16-19 (June 2, 2016).

^[6] *CFTC v. Gelfman Blueprint, Inc.*, Case No. 17-7181 (S.D.N.Y. Filed Sept. 21, 2017) (alleging ponzi scheme purporting to trade Bitcoin); *CFTC v. The Entrepreneurs Headquarters Limited*, Case No. 2:18-cv-00345 (E.D.N.Y. Filed Jan. 18, 2018) (alleging misappropriation of funds in the form of Bitcoins solicited for the purpose of trading in commodity interests).

^[7] There are other theories for supporting a broader interpretation of the CFTC’s authority by treating all virtual currencies as a single commodity, or by interpreting the futures requirement away by focusing on the “or in the future dealt in” to claim anything that *might* in the future be traded in futures is today subject to CFTC jurisdiction. See *U.S. v. Brooks*, 681 F.3d 678 (2012) (determining natural gas is the commodity underlying a futures contract even if located at a different delivery location and noting a theory by which all commodities susceptible to trading as futures might satisfy the futures contract requirement).

[\[8\]](#) The CFTC filed a notice of supplemental authority on March 8, 2018, quoting Judge Weinstein’s decision.