

Article Information

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Service: Blockchain

Sector: Financial Services, FinTech, IT & Telecommunications

Blockchain Bites: CFTC split over OoKi Dao matter, Does the SEC regulate all of Ethereum now?, Markets down, energy up @TOKEN2049

Michael Bacina, Steven Pettigrove and Jordan Markezic of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

CFTC split over OoKi DAO and placing liability on DAO members

Last week, the Commodity Futures Trading Commission (CFTC) simultaneously [filed and settled charges against bZeroX LLC](#) as well as its founders Tom Bean and Kyle Kistner for illegally offering leveraged and margined retail commodity transactions in digital assets – activities only registered futures commission merchants can perform in the US, as well as for various other breaches of the US *Bank Secrecy Act*. The CFTC also filed a federal civil enforcement action in the US District Court for the Northern District of California against Ooki DAO, as bZeroX's successor.

The [CFTC reached a US\\$250,000 settlement](#) with the architects of the Ooki DAO for operating as an unregistered derivatives exchange, and at the same time labelled DAOs unincorporated, for-profit associations in the filing, alleging that members of the DAO were personally liable for the debts of the DAO. It's important to note that this kind of settlement does not create binding legal precedent for future cases, but is often interpreted by the market in deciding how they will behave. It represents an American model of 'regulation by enforcement'.

In the civil enforcement action, the CFTC continues to seek restitution, disgorgement, civil monetary penalties, trading and registration bans as well as injunctions against further regulatory violations. CFTC Chairman Rostin Benham said of the [action](#):

Today's actions demonstrate the CFTC's commitment to aggressively pursuing individuals and their operations who purposefully seek to evade regulatory oversight at the expense of retail customers... I commend our dedicated enforcement team for pursuing this scheme which touches on many areas of concern regarding this growing market.

CFTC [Commissioner Mersinger provided a scathing statement in dissent](#):

While I do not condone individuals or entities blatantly violating the CEA or our rules, we cannot arbitrarily decide who is accountable for those violations based on an unsupported legal theory amounting to regulation by enforcement while federal and state policy is developing. For these reasons, I am respectfully dissenting in this matter.

Commissioner Mersinger expressed his approval of the settlement order against bZeroX LLC, noting that there was nothing new or unusual or those charges and that the prosecution did not need to go so far as labeling all the token holders of the DAO as liable in doing so. The main point of Commissioner Mersinger's [dissent](#) arose out of the CFTC's classification of the Ooki DAO, which was interpreted as making token holders who voted on governance proposals liable for the debts of

the DAO.

Commissioner Mersinger identified the [four following points](#) rejecting the CFTC's approach to determining the liability of token holders in a DAO:

First, not only does this approach fail to rely on any legal authority in the CEA, it also does not rely on any case law relevant to this type of action. Instead, the Commission's approach imposes governmental sanctions for violations of the CEA and CFTC rules based on an inapplicable State-law legal theory developed for contract and tort disputes between private parties;

Second, this approach arbitrarily defines the Ooki DAO unincorporated association in a manner that unfairly picks winners and losers, and undermines the public interest by disincentivizing good governance in this new crypto environment;

Third, This approach constitutes blatant "regulation by enforcement" by setting policy based on new definitions and standards never before articulated by the Commission or its staff, nor put out for public comment; and

Finally, the Commission ignores an alternative, well-established basis for imposing liability for the Ooki DAO's violations of the CEA and CFTC rules in this case - i.e., aiding and abetting liability—that is specifically authorized by Congress and that would solve all of these problems.

Commissioner Mersinger's sentiment is perhaps best summarised in his below comment, which reflects widespread industry view of the serious downsides of ['regulation by enforcement'](#):

The Commission's approach thus picks winners and losers, in an unfair manner. What is more, it affirmatively disincentivizes voting participation in DAO governance generally—and particularly those who may want to vote in a manner that effectuates change to comply with the law. The Commission's approach will have a chilling effect that discourages voting, thereby hindering good governance and the development of a culture of compliance in this setting. The unmistakable take-away from the Commission's definitional approach in these enforcement actions is that those in a DAO community should not vote, even if the governance vote encourages following the law.

The CFTC also put other decentralized protocols on notice in their complaint asserting that any functions which are required to be delivered, decentralised or not, which require registration can only be "lawfully...performed" by a registered market, which of course cannot possibly be a decentralised protocol unless there was a legal wrapper which provided compliance, which would have the effect of severely limiting accessibility.

This problem goes to the heart of the "square peg round hole" issue of securities and other laws not accommodating decentralised systems which operate on an open basis, and pose a significant challenge for regulators to solve. The CFTC's approach in this case amounts to a *de facto* ban on these functions being provided to US citizens, but given they are openly accessible, it may be very difficult for regulators to maintain this approach in the future.

Does the SEC regulate all of Ethereum now?

Following on from last week's news of the Securities and Exchange Commission's (SEC) [lawsuit against crypto influencer Ian Ballina](#) for an alleged failure to register a cryptocurrency as a security before a 2018 ICO, crypto commentators have identified a "supermassive black hole" buried in the complaint at paragraph 69, which reads:

The US-based investors in Balina's pool irrevocably committed to the transaction when, from within the United States, they sent their ETH contributions to Balina's pool. At that point, their ETH contributions were validated by a network of nodes on the Ethereum blockchain, **which are clustered more densely in the United States than in any other country. As a result, those transactions took place in the United States.**

(our emphasis)

This implies a ground for jurisdiction arising from a certain number of Ethereum's validating nodes operating in the US,

which by extension would make all Ethereum transactions globally inherently American by origin and have significant impacts on what law would apply to transactions on Ethereum, including almost all DeFi protocols.

It is estimated that approximately 46% of all Ethereum nodes operate from within the US. Legal commentator Professor [Brian Fyre](#) in the University of Kentucky Law Faculty said:

Saying that enables [the SEC] to characterize doing business on the Ethereum blockchain, as doing business on a US securities exchange... [w]hich, from their regulatory perspective, is convenient. It makes things so much simpler.

The effect of the allegation, if made out and supported by a Court, would be that the SEC could claim all activity on Ethereum was the same as if it was made on any US exchange or payment system, and give a massive jurisdictional reach to the USA over decentralised protocols based purely on a node basis, even if all the parties to a transaction were outside the USA.

Fyre considers, however, that the inclusion of the last sentence that “as a result, those transactions took place in the United States” bears no real significant legal value, and that it would be unlikely for the Court to actually determine the issue:

I think they may be trying to get their vision of what Ethereum is, and how it works, out into the judicial ecosystem... [i]t’s the SEC saying, ‘This entire body of financial activity is within the scope of the stuff that we regulate, and therefore we’re going to regulate all of it.’

The increased attention follows the implication from SEC Chair Gary Gensler that the Ethereum merge would bring the network [closer to the definition of a security](#) in the eyes of the regulator.

Markets down, energy up @TOKEN2049

Over 7000 attendees from 2000 companies packed the Marina Bay Sands in Singapore this week for Asia’s premier crypto and Web3 conference, TOKEN2049. The conference was buzzing with energy after a two year hiatus because of the pandemic. Singapore was also sparking in the lead up to this weekend’s Grand Prix.

A number of recurrent themes returned in panel sessions and conversations with participants across the industry:

1. Bear markets are a time to build.
2. The need for regulatory clarity to encourage adoption.
3. Asia’s outsized role in incubating crypto projects and companies.

In a panel on the macro narrative, Jordi Alexander, Chief Investment Officer at Selini Capital, noted that crypto has become a leading indicator for markets on the way up and the way down. In his view, crypto is closer to bottoming than traditional markets because deleveraging has already happened.

Zaheer Ebtikar from LedgerPrime noted that the No. 1 driver for institutional adoption is regulation:

Institutions are not sure about what they’re not sure about. The industry needs to change the narrative. We are working very closely with regulators. A robust and clear regulatory framework is important for maturation of the asset class.

In a panel on Crypto Market Structure, Thomas Uhm, Head of Crypto Institutional Sales and Trading at Jane Street, observed that:

regulators are not trying to protect you, they’re trying to protect your parents or grandparents or people you’ve unsuccessfully tried to convince to understand cryptocurrency.

Commenting on the MAS’s recent plans to curb cryptocurrency speculation, Uhm noted that “speculation is part of the innovation cycle”. It incentivizes innovation and adoption:

Speculation is a bet on whether we can build a better model or a better world.

Joining a number of crypto-exchange peers on a panel on institutional adoption, Alexander Hoptner, CEO at Bitmex, noted that consolidation in the exchange space is coming, but the timing is unclear.

Tim McCourt at CME Group spoke of CME's positive long term outlook for the space in light of advances in computer science. He added that regulatory clarity would increase the speed of innovation by giving the industry confidence to build.

In a panel on Regulatory Advances in Crypto, Ari Redbord, Head of Legal and Government Affairs at TRM Labs, noted that it is still early days in the regulatory evolution of the space. A comprehensive regulatory framework is the ultimate goal. Regulatory clarity is required for business.

FTX's COO, Constance Wang, commented that people often ask why FTX spend so much time on regulation, observing that we need support of regulators otherwise traditional money and mass retail won't come in.

After two years of pandemic, TOKEN2049 was a great opportunity to connect with new and old friends again in person. That pent up desire to meet in person and exchange ideas at TOKEN2049 revealed a continued optimism across the industry as builders continue to build while navigating crypto winter and a changing regulatory landscape.