Some Legal Issues Surrounding Blockchain and Cryptocurrency
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This is Part 1 of a seven-part series of posts looking at some broad legal issues affecting cryptocurrencies.

DLT vs Territorial Law.

Fiat currencies have declared value stemming from governmental regulation. And “governments” typically are territorial jurisdictions, exercising the fundamentally territorial concepts of law and regulation.

Cyber-currencies function on blockchain, a distributed ledger technology (“DLT”). Because DLT is – and fundamentally must be – decentralized and distributed, it defies conventional notions of, and structures for, the application of law or regulation.

Some Antecedents.

Though hot and new, cryptocurrencies do have some antecedents. The stone currency of YAP in the South Pacific was, in many ways, both virtual and distributed (because its currency value derived from its communally-reported assignment, not from physical possession). See Aleksander Berentsen and Fabian Schar, “A Short Introduction to the World of Cryptocurrencies,” Federal Reserve Bank of St. Louis Review, First Quarter 2018, pp. 1-16 at § 1.4. https://doi.org/10.20955/r.2018.1-16.
Antebellum “Free Banking” notes issued by local banks, or the private money of lumber-company “scrip” were unregulated ancestors of today’s Initial Coin Offerings (“ICOs”). See https://fredblog.stlouisfed.org/2018/07/antebellum-free-banking-and-the-era-of-bitcoin/

But those examples largely were local. In an age when financial markets, capital formation, and exchange flourish due to transparency, credibility, and reliability that are maintained in part by effective regulation, who is to regulate cloud-computing internet-based DLT transactions or cryptocurrencies? And how are they to do it?

Who Regulates & How?

After the 2014 collapse of Mt. Gox underscored the fraud potential posed by cryptocurrencies, regulators have been rushing to participate in the cryptocurrencies as much or more than investors.


The Commodities Futures Trading Commission (“CFTC”) and Securities and Exchange Commission (“SEC”) alternately seem to be competing or cooperating as they assert or deny federal regulatory jurisdiction. The SEC determined in July 2017 that cryptocurrencies might involve securities, The DAO § 21(a) Report, Release No. 81207 (SEC, July 25, 2017), while the CFTC has asserted jurisdiction over leveraged cryptocurrency transactions and trading.

Internationally, some jurisdictions (like Gibraltar) have instituted regulatory regimes trying to be first-to-market as the jurisdiction of choice for cryptocurrencies. The most recent bandwagon seems to be “sandboxes” for more lightly supervised innovation, as announced by the South African Reserve Bank, the UK’s Financial Conduct Authority, and the one announced by the U.S. Consumer Financial Protection Bureau (“CFPB”) on July 18, 2018. Burr blogged here: https://www.burr.com/2018/07/23/consumer-financial-protection-bureau-announces-launch-of-regulatory-sandbox-for-blockchain-technology-and-cryptocurrencies/

An Illustration: In re Tezos.

The problem is illustrated by the investor class-action litigation over the Tezos ICO now pending in the U.S. District Court for the Northern District of California, In re Tezos Securities Litigation, No. 3:17-cv-06850 (N.D. Cal., filed Nov. 26, 2017)(one of four class actions). The suit named, among others, The Tezos Foundation (a Swiss non-profit), run by co-defendants the Brietmans and their company Dynamic Ledger Solutions, all California residents, and Bitcoin Suisse, a financial intermediary services provider. The class litigation concerned an unregistered ICO of Tezos tokens “issued” from Alderney, Channel Islands.

Early motions to dismiss raised jurisdictional arguments that illustrate these problems:

**Personal Jurisdiction.** There were no allegations that Bitcoin Suisse actually provided any services to US participants, so it had not “purposefully availed” itself of the United States forum. The Tezos Foundation’s Arizona-based website was insufficient alone, but Tezos had US employees/agents and
directed extensive marketing and facilitation to US participants at the direction of the California-based Breitmans, so it was subject to US jurisdiction.

**Forum Non Conveniens.** Defendants sought to move the case to Switzerland as a more convenient place for trial. The Court held the offering’s Switzerland forum-selection clause was not controlling because it was based on a mere “browse-wrap” with only an oblique reference and no hyperlink to the actual agreement, rather than a click-wrap or other positive indication of assent.

**Extra-territorial Application of Securities Law.** The Court determined that U.S. law might apply, even under *Morrison v. National Australia Bank, Ltd.*, 561 U.S. 247 (2010) and the “bedrock principle” that US securities laws have no extra-territorial application without express Congressional authority. So where did an internet-based “on chain” transaction occur? The Court held there was a sufficient US nexus to the subscription transaction: (1) By a US participant plaintiff; (2) Through website hosted in California by California-resident defendant Breitman; (3) As a result of marketing efforts targeting US citizens; and (4) Affected and validated by a network of nodes clustered more heavily in US than anywhere else.


Next, in *Part 2: Regulation of ICOs*.

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