Cryptocurrency in Small Bytes: The CFTC Chalks Up a Preliminary Win

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It was only a matter of time before someone made the argument that their cryptocurrency was neither a security nor a commodity. Two of the regulatory authorities with oversight over financial investments, the SEC and the CFTC, have a mandate to protect investors with respect to transactions in securities and commodities, respectively. Until now, the argument has not been made that a cryptocurrency could be neither of the foregoing. Unsurprisingly, the Massachusetts District Court did not find that argument persuasive.

The facts of CFTC v. My Big Coin Pay, Inc. et al are not those on which great cases are based. The defendants allegedly made false statements to the purchasing public regarding their cryptocurrency “My Big Coin,” including stating that the tokens were backed by gold and could be used anywhere Mastercard was accepted. Purchasers could not trade their tokens, in spite of defendants’ statements that the tokens were listed on several exchanges (and defendants’ posting of completely made up pricing information). Rarely has fraud been more clearly stated in a complaint – which may be the reason defendants made a few novel arguments.

Yes, Cryptocurrencies are Commodities

While the SEC has authority over all transactions in tokens that are considered “securities,” the CFTC’s authority lies in “commodities,” as defined in the Commodity Exchange Act (“CEA”). This definition is quite broad, but not completely universal. It encompasses a long list of agricultural products such as “livestock,” “all 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” (except motion picture box office receipts).

The My Big Coin defendants argued that because there were no futures contracts in their cryptocurrency, the cryptocurrency did not fall into the “commodity” definition, and thus was not subject to CFTC jurisdiction. (One wonders whether this would have played into the hands of the SEC given that the token at issue could probably also fall into the category of an “investment contract,” but this question was not addressed by the court.)

The court, however, accepted the CFTC’s argument that because at least some types of cryptocurrencies were the subject of futures contracts, all cryptocurrencies constitute commodities. The court agreed that the CEA lists broad categories of commodities, not a specific enumerated list. For example, “livestock” is listed, not particular species of animals. (Interestingly enough, the CFTC apparently did not argue that cryptocurrencies constitute a “good” or “article,” which arguably are commodities without regard to whether they are the subject of futures contracts or not.)

Yes, the CFTC has authority to prevent Cryptocurrency Fraud

After dispensing with the idea that the defendants could escape CFTC jurisdiction because the cryptocurrency at issue was somehow neither a security nor a commodity, the court turned its attention to another of defendants’ arguments – that the
CFTC does not have authority over fraudulent spot transactions unless those transactions also involve market manipulation. The CFTC’s authority over spot transactions (that is, transactions that are completed “on the spot” and do not involve future delivery) is relatively limited – the agency cannot require that such transactions are conducted on a regulated market – but the CEA itself and CFTC regulations prohibit the use of “manipulative or deceptive” devices in connection with spot transactions. The Massachusetts court specifically rejected the conclusion made by the Central District Court of California in CFTC v. Monex Credit Co. that the CFTC does not have authority over fraudulent transactions unless such transactions also involve market manipulation. This will provide the CFTC with another reference when it argues the appeal in the Monex case.

The overall conclusion that can be drawn from all of this is that fraud (like other crime) does not pay in the cryptocurrency markets. In fact, even if one of the defendants’ theories had prevailed, the CFTC would have laid the groundwork for a prosecution by the Department of Justice, the Federal Trade Commission, or any number of State Attorneys General – none of whom would have been susceptible to similar arguments. While some in the cryptocurrency world view themselves as outside the jurisdiction of any regulation whatsoever, the most basic principles of truth and fairness are always applicable.

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