NOTES & COMMENTS

TAMING THE DIGITAL WILD WEST: THE NEED TO FULLY REGULATE THE CRYPTO MARKET

by
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Despite past doubts from sophisticated investors, cryptocurrencies have fully emerged from the underground and become a hot topic in mainstream financial discussions. At its peak, the global crypto market possessed a market cap of nearly $3 trillion, with the vast amount of that value created in less than two years. But this rapid growth has also come with extreme volatility; now more than a year out from that peak, the global crypto market has shrunk to under $1 trillion and has been riddled by high-profile bankruptcies. On top of this extreme volatility, the largely unregulated crypto market has become an easy target for fraudsters and market manipulators, leaving many crypto investors victimized by schemes that would not be executable with standard, more-regulated financial instruments.

This market cannot remain unregulated. The federal government, cognizant of the risks posed by crypto to investors and the financial system at large, has already begun to consider establishing a regulatory scheme for cryptocurrencies, but time is of the essence. The crypto market is highly complex and must be met with an adequately comprehensive regulatory scheme. While the Securities and Exchange Commission and the Commodity Futures Trading Commission have been viewed as fighting over which agency will be the one to oversee the crypto market, a coordinated approach represents the best avenue for providing

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effective and complete oversight. Without such comprehensive regulation, the crypto market will continue to remain a Wild West-like landscape, characterized by rampant fraud and consumer peril. Just as with any other major innovation, the crypto market must be regulated and consumers must be protected.

I. INTRODUCTION

Innovation and regulation are two sides of the same coin. While the two concepts may seem like opposing forces, at odds with each other in a market setting, the relationship between the two is largely symbiotic: one cannot seek to innovate without the proper regulatory groundwork to assure them that they can bring an innovation to market; and without continuous innovation, a robust and evolving regulatory system becomes unnecessary. With any new technological innovation or advancement, governing authorities must work to institute regulations that encourage the beneficial use of such technologies, while addressing problems and potential harms that are created by these new technologies. A lack of effective regulation can not only hinder an innovation's positive effect, it can also cause a well-intentioned innovation to be actively harmful to the market and consumers.

Cryptocurrency and de-centralized finance have been billed as the next great innovation by those supportive of the crypto market.[1] But while the crypto market

[1] *See, e.g.*, Turner Wright, *Event Recap Web Summit 2021: Crypto, Climate Change and Facebook*, COINTELEGRAPH (Nov. 5, 2021), https://cointelegraph.com/news/event-recap-web-

has grown and become more accepted by investors of all different sophistication levels,[2] the market is still largely characterized by extreme speculation and volatility, high levels of fraud, and a dearth of meaningful regulation.[3] This Wild West-like situation has served as a gold rush for some, allowing them to strike it rich in a quick amount of time with minimal work, but many crypto consumers, often unsophisticated investors who purchased crypto without a full understanding of the market or who fell prey to criminal actors utilizing crypto as means to defraud others, have been left high and dry.[4] FTX, a once highly respected player in the market which ran one of the largest crypto exchanges in the world, has now experienced an utter collapse brought on by intentional fraud and money laundering,[5] and Binance, the current largest crypto exchange in the market, faced legal action and pled guilty to federal charges actively under investigation from the U.S. Department of Justice and may face legal action in the near future.[6] Despite this extreme turmoil, cryptocurrencies continue to be seen as a viable long-term investment,[7] which means Congress has to make a decision about what kind of regulatory action is needed in the crypto space.

summit-2021-crypto-climate-change-and-facebook.

[2] James Royal, *Cryptocurrency Statistics 2023: Investing in Crypto*, BANKRATE (Aug. 31, 2023), https://www.bankrate.com/investing/cryptocurrency-statistics.

[3] *See* Joe Pinsker, *The Investors Who Still Think Crypto Can Make Them Rich*, WALL ST. J., https://www.wsj.com/articles/some-everyday-investors-still-bet-crypto-can-make-them-rich-7107d63e (Feb. 21, 2023, 3:25 PM); Bobby Allyn, *He Lost $340,000 to a Crypto Scam. Such Cases Are on the Rise*, NPR (June 25, 2023, 6:01 AM), https://www.npr.org/2023/06/25/1180256165/crypto-scam-senior-victims-spirebit.

[4] Pinsker, *supra* note 3 ("Though crypto has minted some millionaires and billionaires, the median investor likely lost money as of June 2022, according to the JPMorgan Chase Institute.").

[5] David Yaffe-Bellany, *How Sam Bankman-Fried's Crypto Empire Collapsed*, N.Y. TIMES (Nov. 14, 2022), https://www.nytimes.com/2022/11/14/technology/ftx-sam-bankman-fried-crypto-bankruptcy.html; Marley Jay, Dawn Giel & Phil Helsel, *Sam Bankman-Fried Found Guilty on All Counts at Fraud Trial Over Crypto Exchange FTX*, NBC NEWS, https://www.nbcnews.com/business/business-news/sam-bankman-fried-verdict-ftx-trial-rcna123158 (Nov. 2, 2023, 7:27 PM).

[6] Press Release, U.S. Dep't of Just., Binance and CEO Plead Guilty to Federal Charges in $4B Resolution (Nov. 21, 2023), https://www.justice.gov/opa/pr/binance-and-ceo-plead-guilty-federal-charges-4b-resolution; *see* Tom Wilson, Angus Berwick & Elizabeth Howcroft, *Binance's Books Are a Black Box, Filings Show, as It Tries to Rally Confidence*, REUTERS (Dec. 19, 2022, 12:35 PM), https://www.reuters.com/technology/binances-books-are-black-box-filings-show-crypto-giant-tries-rally-confidence-2022-12-19.

[7] Iain Withers & Lawrence White, *Exclusive: Goldman Sachs on Hunt for Bargain Crypto Firms After FTX Fiasco*, REUTERS (Dec. 6, 2022, 2:22 PM), https://www.reuters.com/technology/goldman-sachs-hunt-bargain-crypto-firms-after-ftx-fiasco-2022-12-06 (reporting on Goldman Sachs's interest in acquiring a foothold in the crypto market to take advantage of what it sees as bargain prices resulting from FTX's bankruptcy).

Other countries have faced this same question and have taken divergent paths. The United States could follow the lead of countries like El Salvador and fully embrace cryptocurrencies as legal tender;[8] put significant restrictions on, or outright ban, cryptocurrencies like China;[9] or take a middle ground approach that balances the dangers and potential benefits of crypto. This Note argues for that middle approach. First, this Note will look at the current landscape of the crypto market, including what cryptocurrencies are, what purposes they are supposed to serve, and how they are used in practice. Then this Note will describe structural issues in the crypto market that have contributed to heightened levels of fraud and harms against consumers. Next, this Note will lay out the current regulatory framework, or lack thereof, for the crypto market and potential legislative changes on the horizon. Finally, this Note will list recommendations that this author believes are needed for a comprehensive crypto regulation that both protects consumers and allows for continuing innovation in the crypto space.

II. THE CRYPTO LANDSCAPE

Cryptocurrencies and other digital commodities may have started out as fringe, underground investment options for those looking to bet against, or troll, the financial establishment, but crypto has since gone mainstream.[10] By 2023, seventeen percent of U.S. adults reported they had "invested in, traded or used a cryptocurrency."[11] At its peak in November 2021, the global crypto market was valued at almost $3 trillion, more than eight times the market cap from the year prior.[12] Crypto exchanges, swimming in newfound money and confident that money would continue to roll in, made huge marketing investments aimed at getting average investors into the market. Crypto commercials appeared during the Super Bowl;[13]

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8 Laurent Belsie, *El Salvador's Experiment with Bitcoin as Legal Tender*, NBER DIGEST, July 2022, at 4, 4.

9 Francis Shin, *What's Behind China's Cryptocurrency Ban?*, WORLD ECON. F. (Jan. 31, 2022), https://www.weforum.org/agenda/2022/01/what-s-behind-china-s-cryptocurrency-ban.

10 Justin Baer, *Bitcoin to Come to America's Oldest Bank, BNY Mellon*, WALL ST. J., https://www.wsj.com/articles/bitcoin-to-come-to-america-s-oldest-bank-bny-mellon-11613044810 (Feb. 11, 2021, 6:54 PM); John Csiszar, *6 Reasons Crypto Has Become So Popular in the Past Two Years*, GOBANKINGRATES (June 1, 2022), https://www.gobankingrates.com/investing/crypto/reasons-crypto-has-become-popular-past-two-years.

11 Michelle Faverio & Olivia Sidoti, *Majority of Americans Aren't Confident in the Safety and Reliability of Cryptocurrency*, PEW RSCH. CTR. (Apr. 10, 2023), https://www.pewresearch.org/short-reads/2023/04/10/majority-of-americans-arent-confident-in-the-safety-and-reliability-of-cryptocurrency.

12 *Global Cryptocurrency Charts: Total Cryptocurrency Market Cap*, COINMARKETCAP, https://coinmarketcap.com/charts (last visited Jan. 30, 2024).

13 Anthony Tellez, *Crypto Ads Are a Super Bowl Talker, with Floating QR Codes and Larry David*, NPR (Feb. 14, 2022, 1:42 PM), https://www.npr.org/2022/02/14/1080237873/

celebrity endorsers began promoting crypto products and attaching their brands to crypto;[14] and some crypto exchanges even bought naming rights to prominent sports arenas.[15] By the end of 2021, crypto optimism was at an all-time high, with many proponents claiming the current crypto boom was just the beginning and that cryptocurrencies and digital assets were set to take over the world of finance.[16]

Those lofty predictions seem off the mark today. The crypto market came crashing back to earth in 2022, bringing about what has been described as the "crypto winter" due to a rapid decline in market value and multiple high profile bankruptcies.[17] One year from its peak, the crypto market saw over $2 trillion of value evaporate into thin air,[18] with Bitcoin and Ethereum, the two largest crypto-currencies, each seeing their price fall by over 70%.[19] Multiple factors contributed

superbowl-ads-crypto-bitcoin.

[14] Corinne Ramey, James Fanelli & Imani Moise, *Celebrities Who Endorsed Crypto, NFTs Land in Legal Crosshairs After Investor Losses*, WALL ST. J., https://www.wsj.com/articles/celebrities-who-endorsed-crypto-nfts-land-in-legal-crosshairs-after-investor-losses-11675097150 (Jan. 30, 2023, 12:34 PM) (listing celebrity endorsers of crypto including Madonna, Tom Brady, and Kim Kardashian, who are now facing civil lawsuits associated with those endorsements); *see also* Tellez, *supra* note 13 (noting Larry David appeared in a commercial for crypto. Ironically, David's commercial involved him passing on the opportunity to invest.).

[15] Jabari Young, *Crypto.com Buys Naming Rights to Lakers' Staples Center in a $700 Million Deal*, CNBC, https://www.cnbc.com/2021/11/17/cryptocom-buys-naming-rights-to-lakers-staples-center-in-a-700-million-deal-.html (Nov. 17, 2021, 12:22 PM); *cf.* Tim Reynolds, *Miami-Dade County Wins Right to Strip FTX Name Off Heat Arena*, NBA (Jan. 11, 2023, 10:48 AM), https://www.nba.com/news/miami-dade-county-wins-right-to-strip-ftx-name-off-heat-arena (reporting on FTX's naming rights deal with the Miami Heat being terminated after FTX's collapse and bankruptcy).

[16] Wright, *supra* note 1. Celsius Network CEO Alex Mashinsky, for example, claimed the rise of crypto would eventually turn the internet into another "app on the blockchain" and "move all the money in the world into digital finance." *Id.* While Mashinsky may still be proven right in the future, things did not go well for him in 2022. Celsius Network, Ltd., his cryptocurrency lending company, was forced to file for bankruptcy in July 2022 and Mashinksy is now facing a civil lawsuit from the New York Attorney General's office for defrauding investors. Rohan Goswami, *New York AG Accuses Celsius Ex-CEO Alex Mashinsky of Defrauding Hundreds of Thousands of Crypto Investors in $20 Billion Collapse*, CNBC, https://www.cnbc.com/2023/01/05/new-york-ag-accuses-celsius-ex-ceo-of-defrauding-crypto-investors.html (Jan. 5, 2023, 3:39 PM).

[17] *E.g.*, Julian Mark & Gerrit De Vynck, *'Crypto Winter' Has Come. And It's Looking More like an Ice Age*, WASH. POST, (Dec. 18, 2022, 6:00 AM), https://www.washingtonpost.com/business/2022/12/18/crypto-winter-ftx-collapse-bitcoin-prices; Kurt Woock, *After a Fall, Crypto Winter Sets In*, NERDWALLET, https://www.nerdwallet.com/article/investing/crypto-winter (Nov. 14, 2022).

[18] *Global Cryptocurrency Charts: Total Cryptocurrency Market Cap*, *supra* note 12.

[19] Ethereum's price fell from $4,732 to $1,098 in the year between November 9, 2021 and November 9, 2022. *Ethereum Price Chart*, COINDESK, https://www.coindesk.com/price/ethereum (last visited Jan. 30, 2024). Bitcoin's price fell from $66,935 to $15,869 in that same

to this extreme downturn. Rising interest rates had a cooling effect on the market and crippled overleveraged crypto entities.[20] The crypto market was also hit hard by the collapse of Terra and Luna. TerraUSD was stable coin pegged to the U.S. dollar to maintain a price of $1.00 and serve as an alternative to the typical volatility of unpegged cryptocurrencies.[21] Luna, a typical cryptocurrency, served as Terra's companion coin and was allowed to fluctuate in price to provide financial backing to maintain TerraUSD's peg, but Luna's price collapsed in May 2022 and brought TerraUSD's price down with it.[22] This collapse wiped out $40 billion in investors' money[23] and created a sell off that erased a quarter of the crypto market's value.[24] But arguably the most important factor currently hurting crypto is increasing mistrust of the market caused by a continued trend of fraud and malfeasance by crypto actors, exemplified by the fall of FTX.[25]

FTX had numerous subsidiaries that performed different crypto-related functions but the company was primarily known for running the second largest crypto exchange in the world by market share.[26] When the Terra-Luna collapse occurred and put other firms and the overall market in jeopardy, FTX and its CEO Sam Bankman-Fried played the white knight and came to the market's rescue with bailout funds when central banks were unwilling to.[27] FTX agreed to provide a combined total of up to $750 million in credit to at-risk crypto firms BlockFi and Voy-

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timespan. *Bitcoin Price Chart*, COINDESK, https://www.coindesk.com/price/bitcoin (last visited Jan. 30, 2024).

[20] James Royal & Brian Baker, *How the Fed Impacts Stocks, Crypto and Other Investments*, BANKRATE (July 26, 2023), https://www.bankrate.com/investing/federal-reserve-impact-on-stocks-crypto-other-investments (noting that restrictive monetary policies caused cryptocurrencies to decline in value); Hannah Lang, *Factbox: The Crypto Crash Hit These Companies the Hardest*, REUTERS (July 28, 2022, 3:28 AM), https://www.reuters.com/business/finance/crypto-crash-hit-these-companies-hardest-2022-07-28 (listed crypto-entity bankruptcies resulting from declining prices in the crypto market).

[21] Woock, *supra* note 17; Mark & De Vynck, *supra* note 17.

[22] Woock, *supra* note 17; Krisztian Sandor & Ekin Genç, *The Fall of Terra: A Timeline of the Meteoric Rise and Crash of UST and LUNA*, COINDESK, https://www.coindesk.com/learn/the-fall-of-terra-a-timeline-of-the-meteoric-rise-and-crash-of-ust-and-luna (Dec. 22, 2022, 1:07 PM).

[23] Woock, *supra* note 17.

[24] Mark & De Vynck, *supra* note 17.

[25] Felix Salmon, *Mistrust Is Back at the Center of the Cryptoverse*, AXIOS (Dec. 17, 2022), https://www.axios.com/2022/12/17/mistrust-is-back-at-the-center-of-the-cryptoverse.

[26] Catarina Moura, *FTX Surpassed Coinbase as Second-Biggest Centralized Crypto Exchange in May*, THE BLOCK (June 1, 2022, 12:29 PM), https://www.theblock.co/linked/149654/ftx-surpassed-coinbase-as-second-biggest-centralized-crypto-exchange-in-may.

[27] Ryan Browne, *Bitcoin Billionaire Sam Bankman-Fried Bails Out Embattled Crypto Firms BlockFi and Voyager*, CNBC, https://www.cnbc.com/2022/06/22/sam-bankman-fried-rescues-crypto-lenders-blockfi-voyager.html (June 24, 2022, 5:02 AM).

ager Digital, becoming the de-facto savior of the crypto market and creating an image of an altruistic company more concerned about upholding trust in the crypto ecosystem then getting ahead itself.[28] However, this veneer of altruism would soon crumble. FTX was forced to file for bankruptcy in November 2022 as a run on deposits from the exchange exposed an $8 billion shortfall in customer funds.[29] Unlike traditional investment banks, which use customer funds for investment purposes, FTX's terms of service did not allow the exchange to use customer deposits in any way.[30] Despite this prohibition, FTX did not properly bifurcate customer funds from general funds, leaving those customer funds unaccounted for in the company's records.[31] While Bankman-Fried claimed that he did not misappropriate client funds and that FTX's only issues were poor accounting practices and growing too fast,[32] the former FTX CEO faced an eight-count indictment from the U.S. Department of Justice that included charges of wire fraud; conspiracy to commit money laundering; conspiracies to commit securities and commodities fraud; and campaign finance violations associated with his management of FTX, and was ultimately convicted of seven counts of wire fraud, securities fraud, and money laundering.[33]

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[28] *Id.* (quoting a tweet from Bankman-Fried, which described the deal as allowing BlockFi to "navigate the market from a place of strength"). Bankman-Fried, a proponent of *effective altruism*, said in an interview that he feels it is FTX's "responsibility to seriously consider stepping in, even if it is at a loss to ourselves, to stem contagion," and protect the overall crypto market. David Gura, *Crypto Billionaire Says Fed is Driving Current Downturn*, NPR (June 19, 2022, 8:38 AM), https://www.npr.org/2022/06/19/1105853170/crypto-billionaire-says-fed-is-driving-current-downturn.

[29] Yaffe-Bellany, *supra* note 5.

[30] FTX TERMS OF SERVICE, §§ 8.2.6(A)–(C) (2022) ("All Digital Assets are held in your Account on the following basis: (A) Title to your digital assets shall at all times remain with you and shall not transfer to FTX Trading. . . . (C) You control the Digital Assets held in your Account. At any time . . . you may withdraw your Digital Assets . . . .").

[31] *See* Andrew R. Chow, *Where Did FTX's Missing $8 Billion Go? Crypto Investigators Offer New Clues*, TIME (Dec. 21, 2022, 4:39 PM), https://time.com/6243086/ftx-where-did-money-go. FTX's general accounting and recordkeeping was so bad in fact, that the bankruptcy trustee assigned to the case—the same trustee to handle the dissolution of Enron and other high profile cases—remarked in a Declaration: "Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred [with FTX]." Decl. of John J. Ray III in Supp. of Ch. 11 Pets. and First Day Pleadings at 2, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. Del. Nov. 17, 2022), ECF No. 24.

[32] Kelsey Piper, *Sam Bankman-Fried Tries to Explain Himself*, VOX (Nov. 16, 2022, 3:20 PM), https://www.vox.com/future-perfect/23462333/sam-bankman-fried-ftx-cryptocurrency-effective-altruism-crypto-bahamas-philanthropy.

[33] Press Release, U.S. Att'y's Off., Dep't of Just., United States Attorney Announces Charges Against FTX Founder Samuel Bankman-Fried (Dec. 13, 2022), https://www.justice.gov/usao-sdny/pr/united-states-attorney-announces-charges-against-ftx-founder-samuel-bankman-fried; Sealed Indictment, United States v. Bankman-Fried, No. 22-cr-00673 (S.D.N.Y. Dec. 9, 2022),

FTX is not the first crypto player to be exposed as a fraud and it won't be the last. Crypto fraud is commonplace in the market.[34] But before discussing the continuing trend of crypto fraud and specific examples of that fraud, it is important to understand what cryptocurrencies really are, how they function, and how inherent characteristics of crypto and the overall market lend themselves to fraud. Regulation can help curb fraud-related issues and protect consumers but only if the underlying problems of crypto are fully understood.

A. *What Is Crypto and What Function Does It Serve?*

Cryptocurrency as a concept is still a fledgling financial innovation with a relatively short history to draw conclusions from. Bitcoin, the first and most well-known cryptocurrency, was created in 2009 as a value token in connection with underlying blockchain technology.[35] A blockchain is a "shared, immutable [digital] ledger that facilitates the process of recording transactions and tracking assets," in a manner that provides for the immediate and transparent sharing of information to other permissioned persons on a network.[36] The digital tokens (i.e., cryptocurrencies), which in the case of Bitcoin and other similar cryptocurrencies, are created through network participants' interactions with the blockchain through digital mining,[37] then reflect a medium of exchange for use on the network.[38] In this way, cryptocurrency tokens have no tangible underlying value in the traditional sense, other than existing as a medium of exchange outside the purview of government and financial institutions.[39]

ECF No. 1; Jay et al., *supra* note 5.

[34] *See, e.g.*, Press Release, Off. of Pub. Affs., Dep't of Just., BitConnect Founder Indicted in Global $2.4 Billion Cryptocurrency Scheme (Feb. 25, 2022), https://www.justice.gov/opa/pr/bitconnect-founder-indicted-global-24-billion-cryptocurrency-scheme; Amitoj Singh, *British National Accused in OneCoin Scam Set to Face US Extradition: Report*, COINDESK, https://www.coindesk.com/policy/2022/08/31/british-national-accused-in-onecoin-scam-set-to-face-us-extradition-report (May 11, 2023, 11:18 AM); Emma Fletcher, *Reports Show Scammers Cashing in on Crypto Craze*, FED. TRADE COMM'N: CONSUMER PROT. DATA SPOTLIGHT (June 3, 2022), https://www.ftc.gov/news-events/data-visualizations/data-spotlight/2022/06/reports-show-scammers-cashing-crypto-craze.

[35] *Frequently Asked Questions*, BITCOIN.ORG, https://bitcoin.org/en/faq (last visited Jan. 29, 2024); *see also* Ingolf G.A. Pernice & Brett Scott, *Cryptocurrency*, INTERNET POL'Y REV. (May 20, 2021), https://policyreview.info/glossary/cryptocurrency.

[36] *What Is Blockchain Technology?*, IBM, https://www.ibm.com/topics/blockchain (last visited Jan. 30, 2024).

[37] *What Is Digital Mining?—Behind the Distributed Ledger Curtain*, OYSTER CONSULTING, https://www.oysterllc.com/what-we-think/what-is-digital-mining-behind-the-distributed-ledger-curtain (last visited Jan. 30, 2024).

[38] Pernice & Scott, *supra* note 35.

[39] *Id.*

Crypto coins and tokens take various forms and functions and can be divided into numerous different subcategories, with these divisions largely based on the intended function of the cryptocurrency itself.[40] There are five primary functional subcategories of cryptocurrencies: bitcoin and altcoins, which are meant only to function as a medium of exchange, although in practice can also be used as a store of value;[41] stablecoins, which serve the same function as regular crypto coins but have their value pegged to another asset class, such as the U.S. dollar, to help stabilize the coin's price; value tokens, which are meant to represent some asset or store of value, such as digital art; utility tokens, which are meant to carry some form of utility with them, such as giving the holder a right to perform certain actions on a blockchain network or facilitate so-called smart contracts, along with holding value; and, security tokens, which denote an ownership stake in an asset, and function as typical securities.[42] The dividers between these subcategories are not bright lines and some coins and tokens have overlapping functions.[43]

Although utility and security tokens can serve added functions in comparison to other cryptocurrencies,[44] from a consumer perspective, the crypto market has been sold as providing two distinct functional values. First, advocates argue crypto increases global access to the mechanisms necessary for financial transactions and provides an alternative to traditional banking and finance.[45] They point to the fact that the "unbanked" global population, "those without a bank account or access to financial services," numbers in the billions and is trending downwards since the

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[40] Coryanne Hicks, *Different Types of Cryptocurrencies*, FORBES, https://www.forbes.com/advisor/investing/cryptocurrency/different-types-of-cryptocurrencies (Mar. 15, 2023, 11:27 PM). The terms "coin" and "token" have distinct meanings in the crypto context. A "crypto coin" is a cryptocurrency that is native to its blockchain and serves primarily as a method of payment. Bitcoin and Litecoin are considered crypto coins. A "crypto token," in contrast, can have more expansive functions and are created on top of already existing blockchains. Nonfungible tokens ("NFTs") and Ether, the token used on the Ethereum network, serve as examples of crypto tokens. *Id.*

[41] *Id.* (The term "altcoin" essentially includes any crypto coin that serves as an "alternative" to bitcoin, meaning any cryptocurrency that qualifies as a "coin" and is not bitcoin.).

[42] *Id.*

[43] José M. Garrido, *Digital Tokens: A Legal Perspective* 7, 24 (IMF, Working Paper No. 23/151, 2023).

[44] Security tokens (also called equity tokens) represent ownership stakes, typically in a company, and confer certain rights, just as a typical security grants the owner certain rights. Brian Nibley, *What Is a Security Token in Cryptocurrency?*, SOFI (Dec. 5, 2021), https://www.sofi.com/learn/content/security-tokens-cryptocurrency. Utility tokens grant their holders a use function, allowing them to perform a specific action on a particular network. Brian Nibley, *What is a Utility Token?*, SOFI (Dec. 22, 2021), https://www.sofi.com/learn/content/what-is-a-utility-token.

[45] Tonantzin Carmona, *Debunking the Narratives About Cryptocurrency and Financial Inclusion*, BROOKINGS INST. (Oct. 26, 2022), https://www.brookings.edu/research/debunking-the-narratives-about-cryptocurrency-and-financial-inclusion.

emergence of crypto technology.[46] These proponents see crypto as supplying financially underserved populations with methods for instant payments, loan opportunities that would not be available otherwise, and low-fee investment access.[47] Second, cryptocurrencies are sold as long-term investment tools to grow the wealth of individuals outside the financial elite.[48] Proponents point to hyperinflation cases in the international community and offer cryptocurrencies as an alternative store of wealth, theoretically protecting consumers from monetary manipulation by government actors.[49] More radical crypto believers have even argued that cryptocurrencies will surpass (or already have surpassed) gold as the premium asset to invest in as a hedge against inflation and market downturns,[50] although this theory should be looked at skeptically given the significant correlation between prices within the crypto market and stock market prices.[51] Both of these narratives around crypto have their problems,[52] but even assuming they present achievable goals for the crypto market, they are not the current primary functions of crypto in practice.

Despite crypto proponents' lofty expectations and progressive sentiments, the crypto market has largely served as a vehicle for extreme financial speculation. Transaction data for Bitcoin accounts demonstrate that the supposed digital currency is generally not used as a medium of exchange and is instead used mainly for speculative investment.[53] This makes sense given the high volatility of crypto prices. The

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[46] *Emerging Technology for Banking the Unbanked*, CRYPTOPEDIA, https://www.gemini.com/cryptopedia/unbanked-defi-fintech-financial-inclusion (June 28, 2022).

[47] *Id.*

[48] Carmona, *supra* note 45; Carmen Reinicke, *Cryptocurrencies Can Be a Tool for Building Personal Wealth Long-Term*, CNBC, https://www.cnbc.com/2021/07/27/cryptocurrencies-can-be-a-tool-for-building-personal-wealth-long-term.html (July 29, 2021, 1:45 PM).

[49] Stephen Stonberg, *Cryptocurrencies Are Democratizing the Financial World. Here's How*, WORLD ECON. F. (Jan. 22, 2021), https://www.weforum.org/agenda/2021/01/cryptocurrencies-are-democratising-the-financial-world-heres-how (laying out how cryptocurrencies can free the global population from centralized institutions).

[50] Jordan Finneseth, *5 Reasons Why Bitcoin Could Be a Better Long-Term Investment than Gold*, COINTELEGRAPH (June 3, 2022), https://cointelegraph.com/news/5-reasons-why-bitcoin-could-be-a-better-long-term-investment-than-gold.

[51] Tobias Adrian, Tara Iyer & Mahvash S. Qureshi, *Crypto Prices Move More in Sync with Stocks, Posing New Risks*, IMF BLOG (Jan. 11, 2022), https://www.imf.org/en/Blogs/Articles/2022/01/11/crypto-prices-move-more-in-sync-with-stocks-posing-new-risks.

[52] High volatility amongst the value of cryptocurrencies hinders their ability to be used effectively as a medium of exchange. Additionally, many actions within the crypto market still require points of contact with established financial institutions, eliminating the supposed benefit of avoiding the need for institutional middlemen. Carmona, *supra* note 45. Regarding crypto's value as an investment, with a lack of underlying intrinsic value and no true use beyond speculation, crypto presents as a high-risk investment for populations that do not have generational wealth to fall back on. *Id.*

[53] Dirk G. Baur, KiHoon Hong & Adrian D. Lee, *Bitcoin: Medium of Exchange or Speculative Assets?*, 54 J. INT'L FIN. MKTS., INSTS. & MONEY 177, 187 (2017).

Financial Stability Oversight Council, a special council within the Treasury Department created under the Dodd–Frank Wall Street Reform and Consumer Protection Act,[54] reported that "[c]rypto-asset prices appear to be primarily driven by speculation rather than grounded in current fundamental economic use cases," leading to huge swings in crypto prices.[55] Since there is no underlying value to ground crypto prices, they wildly fluctuate based on current demand, as reflected by transaction value, and speculation of future uses.

Highly speculative markets are not inherently bad, as they are typically populated by sophisticated investors who understand the risk associated with speculative assets and are usually regulated in ways that are meant to protect unsophisticated investors.[56] The crypto market does not share this characteristic. Not only is the crypto market scantly regulated, but it is also filled with unsophisticated investors; crypto holders skew younger,[57] are relatively more distrustful of the stock market,[58] and typically buy into the crypto market during crypto price spikes rather than during price downturns,[59] demonstrating a lack of sophistication regarding when to invest in the market. While unsophisticated crypto consumers have flooded the market, the overall crypto supply is slowly becoming more concentrated in the hands of a few.[60] This creates a situation where a few parties have immense market share and

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[54] *Financial Stability Oversight Council*, U.S. DEP'T OF THE TREAS., https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc (last visited Jan. 29, 2024).

[55] FIN. STABILITY OVERSIGHT COUNCIL, FACT SHEET: THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION 1 (Oct. 3, 2022), https://home.treasury.gov/system/files/261/Fact-Sheet-Report-on-Digital-Asset-Financial-Stability-Risks-and-Regulation.pdf (discussing characteristics of the crypto activities that contribute to instability within the overall crypto market).

[56] For example, the SEC has promulgated rules regarding the sale of unregistered securities to allow entrepreneurs access to more funding sources, but these regulations distinguish between "accredited investor[s]," who have a certain threshold of capital and are assumed to be sophisticated enough to understand the high risk associated with entrepreneurial investing, and nonaccredited investors, who are assumed to be unsophisticated and require extra protections. 17 C.F.R. § 230.506 (2022).

[57] Royal, *supra* note 2 (noting that both the Millennial and Gen Z generations are overrepresented among crypto owners compared to their proportion of the U.S. population).

[58] Carmona, *supra* note 45.

[59] Chris Wheat & George Eckerd, *The Dynamics and Demographics of U.S. Household Crypto-Asset Use*, JPMORGAN CHASE & CO. (Dec. 2022), https://www.jpmorganchase.com/institute/research/financial-markets/dynamics-demographics-us-household-crypto-asset-cryptocurrency-use (finding that "[m]ost crypto users made their first transactions during spikes in crypto-asset prices").

[60] Paul Vigna, *Bitcoin's 'One Percent' Controls Lion's Share of the Cryptocurrency's Wealth*, WALL ST. J. (Dec. 20, 2021, 5:30 AM), https://www.wsj.com/articles/bitcoins-one-percent-controls-lions-share-of-the-cryptocurrencys-wealth-11639996204 (reporting on research showing that "approximately 0.01% of bitcoin holders control 27% of the currency in circulation.").

institutional knowledge, while the larger consumer base is relatively unknowledgeable and easily taken advantage of. This is especially concerning given the fact the cryptocurrency market arguably functions like a natural pyramid scheme, as the value of investments by early entrants increase as more people buy into the pyramid.[61]

Overall, the crypto market simply does not function as many proponents claim it is meant to. Crypto consumers have not realized the financial-market-distributing benefits that are typically claimed. Instead, these consumers have essentially boarded an investment rollercoaster, riding a wave of speculation and hoping they exit the ride at the right time. Yet, rollercoaster-like volatility isn't the only risk faced by crypto consumers. These consumers also must deal with the rampant fraud and structural problems associated with the unregulated nature of cryptocurrencies.

III. STRUCTURAL PROBLEMS WITH CRYPTO

As discussed previously, the allure of cryptocurrencies is largely premised on their decentralized nature. Decentralized Finance ("DeFi"), which reflects the philosophical underpinnings of cryptocurrencies and blockchain technology, "aim[s] to replace the traditional financial system with one that has no central authority."[62] In this way, cryptocurrencies are sold as a way to "democratize" finance, eliminating the need for government involvement, institutional oversight, or geopolitical barriers like borders or state-backed currencies, and allowing individuals to take full control over their own finances.[63] Crypto proponents argue that trust in government institutions and the traditional financial establishment is misplaced and that the transparently trustless system that forms the crypto market is the preferable alternative to the current system.[64]

By definition, this trustless system argument requires the crypto market to exist in an unregulated state in order to maintain decentralization as financial regulation by institutional actors is the exact result that DeFi counsels against.[65] But while

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[61] CNBC Television, *Bitcoin Is 'a Giant Pyramid Scheme,' Says Pinboard Founder*, YOUTUBE (May 20, 2021), https://www.youtube.com/watch?v=igOmWeHMunw&ab_channel=CNBC Television; Caleb Naysmith, *Yes, All Crypto Is Just a Pyramid Scheme*, MEDIUM (Dec. 13, 2021), https://medium.com/geekculture/yes-all-crypto-is-just-a-pyramid-scheme-3878e6561b3c.

[62] Amber Smith, *What Are the Advantages of Decentralized Finance?*, BLOCKCHAIN COUNCIL (Nov. 4, 2022), https://www.blockchain-council.org/info/what-are-the-advantages-of-decentralized-finance.

[63] *Id.*; Stonberg, *supra* note 49.

[64] *See What Does Trustless Mean?*, CRYPTOPEDIA, https://www.gemini.com/en-US/cryptopedia/trustless-meaning-blockchain-non-custodial-smart-contracts (June 28, 2022). *See generally What Does Trustless Mean in Crypto?*, BCB GROUP (Oct. 4, 2022), https://www.bcbgroup.com/what-does-trustless-mean-in-crypto.

[65] *See What Does Trustless Mean?*, *supra* note 64.

nonregulation may make sense to DeFi crypto purists, it unmistakably exposes crypto consumers to higher risks of fraud and malfeasance,[66] and creates a perception of mistrust that limits overall growth of the crypto market.[67] Crypto's history is filled with examples of fraud, both on the individual and systemic level. This Section will examine some of those examples of fraud and systemic issues and look to how Crypto's largely unregulated state contributes to problematic conduct and negative results for many consumers.

A. *Crypto-Related Fraud*

Fraudulent schemes and financial scams have been commonplace throughout history and are obviously not unique to crypto, but the crypto market in its current form is especially susceptible to opportunistic scammers and fraudsters. Crypto-based scams are not particularly complicated or special. In fact, most fraudulent crypto schemes follow the same playbook used by traditional scammers, deploying basic deceptive techniques such as phishing scams, where fraudsters attempt to trick consumers into handing over crypto or digital wallet information through misleading communications; pump and dump or rug pull schemes, where unscrupulous crypto creators set up a new cryptocurrency and make significant promises to drum up demand but instead take investors' money and run; Ponzi schemes, where scammers promise high returns for investors but just use future investor's money to pay back old investors; and affinity-based tactics, where trusted individuals, often celebrities in the context of crypto-based affinity scams, are used to promote fraudulent cryptocurrencies or crypto products.[68]

The FTC has reported that from January 1, 2021 to March 31, 2022, over $1 billion worth of crypto was lost to these crypto-based scams, with this amount reflecting almost 25% of all payment-based scams for that time period.[69] Many of the scams reported to the FTC were presented to victims as investment opportuni-

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[66] *See* Fletcher, *supra* note 34 (stating that "more than 46,000 people have reported losing over $1 billion," representing almost "one out of every four dollars reported lost, more than *any* other payment method."); Brean Horne & Dalia Ramirez, *Cryptocurrency Scams Explained*, NERDWALLET (Nov. 7 2022, 10:49 AM), https://www.nerdwallet.com/article/investing/cryptocurrency-scams (noting that due to decentralization of the market, irreversibility of transactions on the blockchain, and heavy usage of pseudonyms instead of legal names by transacting parties, "[t]hough cryptocurrency can be an attractive investment, it's more susceptible to scams than any other payment method").

[67] *See* Salmon, *supra* note 25 (explaining that DeFi enthusiasts are pushing for a return to a true trustless system, but average consumers mistrust the market based on recent crypto entity collapses).

[68] Horne & Ramirez, *supra* note 66.

[69] Fletcher, *supra* note 34.

ties, utilizing social media as the method of contact and targeting younger consumers.[70] Yet these scams do not just affect individuals; U.S. banking regulators have even warned financial institutions to avoid exposing themselves to the crypto market in order to avoid falling prey to crypto scams.[71] This disproportionate risk of being defrauded within the crypto market can largely be attributed to the fact that there is "no . . . centralized authority to flag suspicious transactions and attempt to stop fraud before it happens," along with other contributing factors such as the irreversibility of crypto transfers on the blockchain and a general lack of understanding about how cryptocurrencies work amongst average consumers.[72] Crypto consumers are essentially left to fend for themselves when it comes to staving off crypto-based scams, which produces predictable results. During the 15-month period looked at by the FTC, 46,000 people were scammed out of at least part of their crypto holdings, with the median victim losing $2,600 worth of crypto.[73]

There have been multiple high-profile cases of bad actors establishing fraudulent cryptocurrencies or crypto-based ventures and using them as a vehicle to defraud consumers. For example, crypto pyramid schemers Karl Greenwood and Ruja Ignatova claimed their cryptocurrency "OneCoin" would be the "Bitcoin killer," promising significant returns for investors, but they instead used the "entirely worthless" OneCoin to scam over three million investors out of more than $4 billion in just a two-year span.[74] Communications between the two founders demonstrate they were considering an exit strategy starting in 2014 and knew their scheme relied on targeting unsophisticated and uninformed crypto consumers.[75] BitConnect founder Satish Kumbhani used his fraudulent investment platform to run a Ponzi scheme that pilfered $2.4 billion from investors by claiming BitConnect's "Lending Program" would use proprietary trading technology to produce guaranteed returns on the volatile crypto market.[76] Kumbhani's claims were false and he

[70] *Id.*

[71] Hugh Son, *Regulators Warn U.S. Banks on Crypto Risks Including 'Fraud and Scams' After FTX Collapse*, CNBC, https://www.cnbc.com/2023/01/03/regulators-warn-us-banks-on-crypto-risks-including-fraud-and-scams.html (Jan. 3, 2023, 7:49 PM).

[72] Fletcher, *supra* note 34.

[73] *Id.*

[74] Press Release, U.S. Att'y's Off., S.D.N.Y., Co-Founder of Multibillion-Dollar Cryptocurrency Scheme "OneCoin" Sentenced to 20 Years in Prison (Sept. 12, 2023), https://www.justice.gov/usao-sdny/pr/co-founder-multibillion-dollar-cryptocurrency-scheme-onecoin-sentenced-20-years-prison. Greenwood was arrested in Thailand and extradited to the United States in 2018 and has now pled guilty to federal wire fraud and money laundering charges associated with the scheme. Ignatova, a.k.a. "the Crypto Queen," is still at large. *Id.*

[75] *Id.*

[76] Press Release, Dep't of Just., *supra* note 34.

was instead only paying off old investors with new investors' money, while also manipulating the price of BitConnect's digital currency, BitConnect Coin, to create a false sense of demand for the coin.[77]

While the above examples of particularized, large-scale fraud resulted in attention-grabbing headlines, these types of deceptions are rampant in the crypto market and come in many different shapes and sizes. The Wall Street Journal examined 1,450 digital coin offerings and found that 271 of those offerings contained some form of red flag, including "plagiarized investor documents, promises of guaranteed returns and missing or fake executive teams."[78] Ironically, these types of initial coin offerings are one area of the cryptocurrency market that, as will be discussed more in-depth later, can fall under the Security and Exchange Commission's (SEC) regulatory umbrella; but the SEC still warns about the increased risk of fraud associated with these offerings.[79] Crypto consumers also have to be wary of pump-and-dump schemes using joke or "meme" coins, which are typically valueless coins created and branded using some sort of joke or pop culture reference.[80] Founders of these meme coins can use their control over a large amount, if not all, of the supply of the coin to their advantage by trying to create artificial demand and hype around the coin, then unloading their holdings at a peak price right before the meme coin collapses in value, making off with outsized profits at the expense of speculating consumers.[81]

Overall, consumers must be aware of the outsized risk of fraud within the crypto market and the numerous schemes used by individual scammers if they are going to protect their money. If consumers do fall victim to scammers, they are largely left with no recourse to recover their losses and can only hope that the financial predators face some sort of accountability from law enforcement. Individual scammers are not the only threat facing crypto consumers though. Consumers also face threats of fraud and deceptive behavior from the exchanges they use to trade crypto as well.

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[77] *Id.*

[78] Shane Shifflett & Coulter Jones, *Buyer Beware: Hundreds of Bitcoin Wannabes Show Hallmarks of Fraud*, WALL ST. J., (May 17, 2018, 12:05 PM), https://www.wsj.com/articles/buyer-beware-hundreds-of-bitcoin-wannabes-show-hallmarks-of-fraud-1526573115.

[79] *Cryptocurrency/ICOs*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/ICO (June 23, 2023) ("While some ICOs may be attempts at honest investment opportunities, many may be frauds . . . . They may also present substantial risks for loss or manipulation, including through hacking, with little recourse for victims after-the-fact.").

[80] Dan Ashmore, *What Are Meme Coins? Are They Worth Investing In?*, FORBES: ADVISOR, https://www.forbes.com/advisor/investing/cryptocurrency/what-are-meme-coins-are-they-worth-investing-in (Aug. 4, 2022, 1:34 PM).

[81] *Id.*

B. *Crypto Exchanges and Fraudulent Behaviors*

The trustless and unregulated structure of the crypto market allows cryptocurrency exchanges and brokerages to deploy deceptive practices and behave in ways that can be actively harmful to consumers and overall faith in the market. For example, crypto exchanges or individual parties on an exchange can artificially inflate trading numbers on a platform through the practice of "wash trading," which involves buying and selling the same crypto coin or asset multiple times to generate fake trading volume and create the appearance of high demand for an asset.[82] This practice can mislead crypto consumers about the overall value of a particular cryptocurrency and is extremely difficult to detect without specialized technology and a high level of expertise in the area.[83] Wash trading is also not a minor issue in the crypto space. In an investigation of 157 crypto trading platforms worldwide, Forbes estimates that more than half of all crypto "trading volume is likely to be fake or non-economic."[84] For exchanges operating outside the regulatory purview of the United States, wash trading is even more prevalent, with one study estimating a staggering 70% of trading volume results from the practice.[85] These numbers make it clear that consumers largely cannot trust the trading volume numbers they see in the crypto market.

On top of inflated trading numbers, crypto consumers must also worry about the high rate of bankruptcies among crypto exchanges and trading companies and the consequences that occur because of those bankruptcies. While U.S corporate bankruptcy filings fell to a new 13-year low in 2022,[86] crypto companies experienced a significant uptick in bankruptcy filings, including multiple high-value bankruptcies with over $1 billion in liabilities.[87] These crypto-related bankruptcies can

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[82] Cheyenne DeVon, *Mark Cuban Predicts This Will Be the 'Next Possible Implosion' in Crypto—Here's How to Avoid It*, CNBC (Jan. 12, 2023, 2:22 PM), https://www.cnbc.com/2023/01/12/mark-cuban-next-crypto-implosion-may-be-uncovering-wash-trading.html.

[83] *Id.* For this reason, market experts advise only using crypto exchanges that have subjected themselves to regulation and that utilize market surveillance technology to prevent wash trading practices. *Id.*

[84] Javier Paz, *More than Half of All Bitcoin Trades Are Fake*, FORBES (Aug. 26, 2022, 6:30 AM), https://www.forbes.com/sites/javierpaz/2022/08/26/more-than-half-of-all-bitcoin-trades-are-fake.

[85] Lin William Cong, Xi Li, Ke Tang & Yang, *Crypto Wash Trading* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 30782, 2022), https://www.nber.org/system/files/working_papers/w30783/w30783.pdf.

[86] Michael O'Connor & Chris Hudgins, *U.S. Corporate Bankruptcy Filings Sink to New Low in 2022*, S&P GLOBAL MKT. INTEL. (Jan. 6, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcy-filings-sink-to-new-low-in-2022-73708392.

[87] *Id.*; Julian Mark, *The Companies that Helped Create 2022's 'Crypto Winter*,' WASH. POST, https://www.washingtonpost.com/business/2022/12/05/crypto-ftx-collapse-bankruptcy-

be especially problematic for consumers. To begin, with the lack of regulation and oversight in the market, many failed and fraudulent crypto exchanges have vanished without a trace, failing to even file for bankruptcy or notify users of their departure from the market and leaving creditors no way to recoup lost digital assets.[88] Even when crypto exchanges and brokerages do go the legitimate route and file an official bankruptcy petition, there is no guarantee consumers-turned-potential-creditors will actually see any of their money returned to them, as many of the legal questions in this bankruptcy context remain unanswered.[89]

When a crypto consumer deposits money in an account under a crypto exchange or crypto broker, or uses those funds to buy crypto assets that remain in accounts with the exchange or broker, it is an unanswered question if those funds or crypto assets belong to the crypto company overseeing the account or if the consumer maintains ownership over those funds.[90] This question along with what priority crypto consumers-turned-creditors receive in a crypto bankruptcy, and other important questions, are left uncertain because Congress has failed to establish any overarching regulatory scheme for the crypto market that would provide answers to those questions. Instead, bankruptcy judges will have to decide these questions in a piecemeal fashion as cases arise.[91] Based on recent developments in a few current crypto bankruptcy cases, this approach to handling the collapse of certain crypto entities is unlikely to produce positive results for crypto consumers.

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companies (Dec. 13, 2022, 11:34 AM) (chronicling the high profile bankruptcies within the crypto space that shook the market and contributed to the "crypto winter" of 2022); Karl Angelo Vidal & Annie Sabater, *Bankruptcy Filings of U.S. Private Equity-Backed Companies Inch up in 2022*, S&P GLOBAL MKT. INTEL. (Dec. 27, 2022), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/bankruptcy-filings-of-us-private-equity-backed-companies-inch-up-in-2022-73521126 (noting that cryptocurrency companies have "had a disastrous year").

[88] Dan Ashmore, *42% of Failed Crypto Exchanges Completely Vanished, Leaving Users in the Lurch*, COINJOURNAL (July 19, 2022), https://coinjournal.net/news/42-percent-of-failed-crypto-exchanges-vanished-leaving-users-in-the-lurch.

[89] Steven Church, *FTX, Celsius Bankruptcies Turn Judges into De Facto Regulators*, BLOOMBERG L. (Feb. 8, 2023, 5:00 AM), https://news.bloomberglaw.com/bankruptcy-law/crypto-cases-with-billions-on-line-push-judges-into-legal-void.

[90] Sidney P. Levinson, Erica S. Weisgerber, Elie J. Worenklein & Ezra Newman, *Recent Crypto Bankruptcy Filings May Provide Clarity to Critical Unresolved Questions*, DEBEVOISE & PLIMPTON (July 14, 2022), https://www.debevoise.com/insights/publications/2022/07/recent-crypto-bankruptcy-filings-may. The inquiry into whether those funds and digital assets are considered corporate assets in a bankruptcy proceeding or remain the property of the crypto consumers who technically own them is a highly fact-specific inquiry that involves analyzing the intent of the parties through the agreements between them and whether those assets are comingled with the bankrupt entity's assets or readily identifiable. *Id.*

[91] Church, *supra* note 89.

One bankruptcy court has already ruled that the terms of service for a crypto entity can be drafted in a legally sufficient way to make the crypto entity, not the crypto consumer, the ultimate owner of digital assets held in accounts under that crypto entity. As part of the bankruptcy proceeding for Celsius Network, LLC ("Celsius"), the U.S. Bankruptcy Court for the Southern District of New York had to decide who was the owner of cryptocurrency assets totaling $4.2 billion in value, held within Earn Accounts with Celsius.[92] While the Earn Account holders argued the crypto assets held in those accounts rightfully belonged to them, the court disagreed and found that the Celsius terms of service made it clear that those assets were the property of the company and therefore distributable to debtors in the bankruptcy case.[93] This left Celsius's crypto consumers as unsecured debtors in the bankruptcy, with no guarantee that they would recover the value of their digital assets since secured creditors would have priority over them.[94] The court made this determination despite arguments from the Earn Account holders that the terms of service contract was unconscionable and nullified by misrepresentations and misleading conduct on the part of Celsius.[95]

While other crypto consumers must worry about this same situation happening to them, normal investors using traditional brokerage services to invest in the stock market do not have to worry about this issue. This is because securities brokerages can utilize a liquidation process separate from Chapter 7 bankruptcy, which protects investors' stock investments,[96] and brokerages typically do not own the securities

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[92] *In re* Celsius Network LLC, 647 B.R. 631, 636–37 (Bankr. S.D.N.Y. 2023).

[93] *Id.* at 637, 651. The court made this determination based on unambiguous terms in the Celsius terms of service, which demonstrated that Celsius was the owner of these assets, including language such as, "[Earn Account Holders] grant Celsius . . . all right and title to such Eligible Digital Assets, including ownership rights, and the right, without further notice to you, to hold such Digital Assets in Celsius' own Virtual Wallet . . . and to . . . sell, lend, or otherwise transfer or use any amount of such Digital Assets," *id.* at 640 (alteration in original), and "[i]n the event that Celsius becomes bankrupt . . . any Eligible Digital Assets used in the Earn Service or as collateral under the Borrow Service may not be recoverable, and you may not have any legal remedies or rights in connection with Celsius' obligations to you other than your rights as a creditor of Celsius under any applicable laws." *Id.*

[94] *Id.* at 651.

[95] *Id.* at 645. The court rebutted these arguments by pointing to the unambiguous terms of use quoted *supra* note 93 and applying standard contract law principles to find that both parties mutually consented to the agreement. *Id.* at 652–56.

[96] 15 U.S.C. § 78eee; *Securities Investor Protection Act (SIPA)*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/securities-investor-protection-act-sipa (last visited Jan. 30, 2024) (explaining that "[t]ypically, when a brokerage firm fails, the Securities Investor Protection Corporation (SIPC) arranges the transfer of the failed brokerage's accounts to a different securities brokerage firm [or] sends investors either certificates for the stock that was lost or a check for the market value of the shares").

assets they hold for their consumers.[97] No such protections currently exist for crypto consumers.[98]

Crypto consumers must also be concerned about crypto exchanges or brokerages mishandling, losing, or flat-out stealing their crypto assets or money. In the same memorandum opinion issued in *In re Celsius Network*, the court noted that even if it were to determine that the Earn Account holders still owned their crypto assets in the Earn Accounts, they would not be able to recover the full value of their assets as the debtor's estate did not have sufficient assets in the estate to make them whole, noting that debtors "do not have enough coin to give everybody their coin back in kind."[99] The consumer's money and digital assets were gone because Celsius had lost them all.

Celsius is not the only crypto company to lose its customers' funds. FTX's collapse into bankruptcy brought to light the fact that the company lost over $8 billion of customer money, which authorities are still trying to track down.[100] These billions—reflecting money that FTX exchange users deposited for the purpose of trading crypto assets—are entirely unaccounted for due to FTX's failure to adhere to standard accounting practices and FTX's lack of financial recordkeeping.[101] While it appears that much of this customer money may have been improperly used by FTX to pay off risky bets made by other entities under the FTX umbrella, there are currently no definitive answers to this question as these user funds were improperly comingled with company funds due to FTX's poor accounting practices, making it extremely difficult to track where the funds went.[102] Former FTX CEO Sam Bankman-Fried claimed that the $8 billion was lost through innocent mistakes in recordkeeping, but authorities alleged Bankman-Fried purposely defrauded customers from the start and stole customer funds to cover his own cryptocurrency bets.[103]

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97 *Investor Bulletin: Holding Your Securities*, U.S. SEC. & EXCH. COMM'N: INVESTOR.GOV (July 12, 2023), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-103.

98 Greg Iacurci, *As BlockFi Files for Bankruptcy, What to Know About Crypto Investor Protections*, CNBC, https://www.cnbc.com/2022/11/28/what-to-know-about-crypto-investor-protections-as-blockfi-files-for-bankruptcy.html (Nov. 28, 2022, 12:48 PM).

99 *Celsius*, 647 B.R. at 651 n.26.

100 Chow, *supra* note 31.

101 *Id.*; Decl. of John J. Ray III, *supra* note 31, at 24 (explaining that the company "did not keep complete books and records of their investments and activities" and that due to this failure in record keeping, "[t]he Debtors are creating a balance sheet and other financial statements . . . . from the 'bottom-up'").

102 *See* Decl. of John J. Ray III, *supra* note 31, at 23–24; Chow, *supra* note 31.

103 Rohan Goswami & MacKenzie Sigalos, *How Sam Bankman-Fried Swindled $8 Billion in Customer Money, According to Federal Prosecutors*, CNBC, https://www.cnbc.com/2022/12/18/how-sam-bankman-fried-ran-8-billion-fraud-government-prosecutors.html (Dec. 19, 2022, 2:06 PM).

Adding fuel to these claims, two high-ranking former FTX executives had already pled guilty to fraud charges and cooperated with prosecutors.[104]

The collapse of FTX also highlights other structural issues with the crypto market, such as the rapid fluctuation in asset values, as well as the vulnerability to manipulation by market actors, and how these issues can play out in crypto related bankruptcies. FTX and other crypto-related bankruptcies have involved "run on the bank"-like situations where a cryptocurrency's value rapidly deteriorates as holders rush to sell off the asset, causing the crypto entity who is financially tied to that cryptocurrency to rapidly deteriorate in value.[105] This process can occur in a matter of days, if not hours, and can leave crypto consumers with no realistic ways to protect investments that are being held by quickly crumbling companies since no regulations exist to create this protection. Additionally, there is some evidence that actors in the market may be contributing to these bank runs. For example, federal prosecutors believed that Sam Bankman-Fried used trading firm Alameda Research to manipulate the market and help orchestrate the collapse of cryptocurrencies TerraUSD and Luna,[106] while Binance, the largest exchange in the crypto market, was thought to have helped cause the collapse of FTX by shorting the FTX token,[107] although Binance CEO Changpeng Zhao denied this claim.[108] Ironically, Binance suffered from the same shortcomings and committed similar fraudulent acts as FTX.[109] Reporting found that the company kept most of their actual finances out of any public filings and Binance "actively avoided oversight," attempting to shield itself from regulatory scrutiny.[110]

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[104] *Prosecutors Charge Two Top Executives in Connection with FTX Collapse*, REUTERS (Dec. 22, 2022, 7:17 AM), https://www.reuters.com/technology/two-top-executives-plead-guilty-connection-with-ftx-collapse-us-prosecutor-2022-12-22.

[105] George Selgin, *Bank and Crypto Runs: F(ac)TX vs Fiction*, CATO INST. (Nov. 21, 2022, 10:15 AM), https://www.cato.org/blog/bank-crypto-runs-factx-vs-fiction ("Although cryptocurrency exchanges aren't banks, some, including FTX, operate like banks . . . . Consequently, their customers can stage runs . . . .").

[106] Emily Flitter, David Yaffe-Bellany & Matthew Goldstein, *FTX Founder Sam Bankman-Fried Is Said to Face Market Manipulation Inquiry*, N.Y. TIMES (Dec. 7, 2022), https://www.nytimes.com/2022/12/07/business/ftx-sbf-crypto-market-investigation.html (explaining that federal prosecutors in the Manhattan office are looking into whether the FTX CEO manipulated the market by taking out a large short position on Luna, helping to cause the crash in prices, and seeking to benefit FTX's position in the market).

[107] Selgin, *supra* note 105.

[108] Changpeng Zhao (@cz_binance), TWITTER (Nov. 13, 2022, 8:10 PM), https://twitter.com/cz_binance/status/1592007106806390784 ("Full disclosure: Binance never shorted [FTX].").

[109] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (June 5, 2023), https://www.sec.gov/news/press-release/2023-101.

[110] Wilson et al., *supra* note 6.

IV. CURRENT REGULATIONS IN CRYPTO

SEC officials have described the crypto market as "the Wild West" due to the lack of any tangible regulator protections for investors.[111] This description seems warranted given the multitude of already-discussed pitfalls for consumers in the crypto market.[112] Despite immense growth in the popularity of cryptocurrencies and the continued development of the market, the regulatory framework around it, or lack thereof, has largely remained the same.[113] Both the SEC and the Commodity Futures Trading Commission (CFTC) have some regulatory power around certain cryptocurrencies and certain crypto-based transaction but, as will be discussed below, neither federal agency has comprehensive oversight authority over the crypto market as a whole and many cryptocurrencies and crypto-based transactions can largely avoid federal scrutiny.[114]

Instead, crypto companies face different registration regulations on a state-by-state basis.[115] These registration regulations largely center around whether a state considers cryptocurrencies "money" and are therefore subject to money transmitter laws within the state, but since many states have not provided concrete guidance for crypto companies to use and only a few states have attempted to pass comprehensive regulator frameworks, crypto-based entities have been left in the dark.[116] Additionally, states have taken conflicting approaches as some have sought to embrace crypto as a boon to their economy, while others have sought to restrict the crypto market within their state in an effort to protect consumers.[117] Even more concerning, many major crypto companies have sought to avoid U.S. regulations altogether by incorporating and basing their operations out of foreign countries with relatively low levels of regulation.[118] The lack of comprehensive federal oversight and the piecemeal approach of state regulation allows crypto promoters to effectively pick their

[111] Gary Gensler, *Remarks Before the Aspen Security Forum*, SEC. & EXCH. COMM'N (Aug. 3, 2021), https://www.sec.gov/news/speech/gensler-aspen-security-forum-2021-08-03 (explaining that crypto as an "asset class is rife with fraud, scams, and abuse . . . . If [regulators] don't address these issues, I worry a lot of people will be hurt.").

[112] *See supra* Part II.

[113] Josias Dewey & Samir Patel, *Blockchain & Cryptocurrency Laws and Regulations 2023: USA*, GLOB. LEGAL INSIGHTS, https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/usa (last visited Jan. 30, 2024); *see also* Csiszar, *supra* note 10.

[114] *See notes* 124–181 and accompanying text.

[115] *Cryptocurrency Laws and Regulations by State*, BLOOMBERG L. (May 26, 2022), https://pro.bloomberglaw.com/brief/cryptocurrency-laws-and-regulations-by-state.

[116] *State Regulations on Virtual Currency and Blockchain Technologies*, CARLTON FIELDS, https://www.carltonfields.com/insights/publications/2021/state-regulations-on-virtual-currency-and-blockchain-technologies-(updated-march-2021) (Mar. 15, 2021).

[117] Dewey & Patel, *supra* note 113.

[118] *See generally* Michael Lavere, *Where Is Binance Located?*, CRYPTOGLOBE (May 29, 2022), https://www.cryptoglobe.com/latest/2022/05/where-is-binance-located (chronicling Binance's

regulator by choosing where to incorporate, contributing to deceptive and criminal behavior in the crypto market.[119]

This fragmented and insufficient regulatory system is exacerbated by the fact cryptocurrency as a product can be categorized in many ways, with each different category placing digital assets in a different regulatory bucket under a different federal agency.[120] The Biden administration issued an executive order calling on federal agencies to increase enforcement actions in the crypto space, but this order did not settle the question of which agency would be the primary regulator.[121] That said, the bulk of enforcement action against crypto entities has come from the SEC and CFTC.[122] While the SEC and CFTC have done what they can to police the crypto market with their current enforcement powers, their lack of direct authority over the crypto market prevents them from employing proscriptive protections for consumers and limits the agencies to only taking retroactive action.[123] The following Sections will discuss the SEC and CFTC's current efforts to regulate the crypto market and the holes in both agencies' ability to regulate in this space that can only be fixed by congressional action.

A. *SEC and Its Regulatory Position in the Crypto Market*

The Securities and Exchange Commission oversees $118 trillion worth of annual securities trading, reviews the financials of approximately 5,248 publicly listed companies, and monitors the activities of over 29,000 participants in the U.S. securities market.[124] These statistics reflect an immense regulatory lift, but as that context alludes to, the SEC's regulatory authority is limited to activities associated with

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multiple moves from different countries, including Malta and the Cayman Islands, to avoid regulatory scrutiny); Leo Schwartz, *FTX Broke Ground on a $60M Bahamas Headquarters in April. Construction Never Started*, FORTUNE: CRYPTO (Nov. 17, 2022, 10:44 AM), https://fortune.com/crypto/2022/11/17/ftx-broke-ground-on-a-60m-bahamas-headquarters-in-april-construction-never-started ("FTX moved its headquarters from Hong Kong to the Bahamas in September 2021, citing the favorable regulatory environment.").

[119] Aditya Narain & Marina Moretti, *Regulating Crypto*, INT'L MONETARY FUND: FIN. & DEV., https://www.imf.org/en/Publications/fandd/issues/2022/09/Regulating-crypto-Narain-Moretti (last visited Jan. 30, 2024).

[120] Jason P.W. Halperin & Edmund P. Daley III, *Who Will Be the Crypto Regulator and Why It Matters*, N.Y. L.J. (Dec. 5, 2022), https://www.law.com/newyorklawjournal/2022/12/02/who-will-be-the-crypto-regulator-and-why-it-matters (pointing out that "[t]he same digital asset might look like taxable property to the IRS, currency to FinCEN, a commodity to the CFTC, or a security to the SEC").

[121] Exec. Order No. 14,067, 87 Fed. Reg. 14143 (Mar. 14, 2022).

[122] *2023 Crypto Enforcement Trends: SEC & CFTC Set Records as States Take the Lead*, SOLIDUS LABS, https://www.soliduslabs.com/research/2023-crypto-enforcement-trends (last visited Jan. 30, 2024).

[123] Halperin & Daley, *supra* note 120.

[124] *About the SEC*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/strategic-plan/about

the buying, selling, and marketing of securities.[125] As long as a cryptocurrency qualifies as a security, then the SEC has both registration and enforcement authority over that cryptocurrency[126] and the ability to prosecute fraud associated with the buying, selling, or marketing of the cryptocurrency.[127]

The problem faced by the SEC in its efforts to regulate the crypto market is that not all cryptocurrencies listed on crypto exchanges qualify as securities. While some cryptocurrencies "are subject to . . . securities laws and must work within [the SEC's] securities regime,"[128] the SEC has already admitted that the two biggest cryptocurrencies, bitcoin and ether—the token used on the Ethereum blockchain—do not qualify as securities.[129] This leaves the SEC severely limited in its ability to regulate crypto and tasked with the tedious responsibility of sorting out which cryptocurrencies are, and are not, securities. If a cryptocurrency does not fall under the statutory definition for securities, then the SEC can't regulate it.[130]

The statutory definition of "securities" includes a multitude of financial instruments used for speculation or investment, but, of course, does not include any explicit reference to cryptocurrencies.[131] For a cryptocurrency to qualify as a security, it must fall under one of the listed terms in the statutory definition for a security. In practice, this means the cryptocurrency must fall under the definition of an "investment contract," which was defined by the Supreme Court in the case *SEC v. W. J. Howey Co*.[132] Based on the Court's interpretation of "investment contract" in *W.J. Howey Co.*, a cryptocurrency is only a security, and subject to SEC oversight, if it is purchased as an investment "in a common enterprise" where the purchaser is "led to expect profits solely from the efforts of the promoter or a third party."[133] The court emphasized that this inquiry is flexible and based on the circumstances at

(Apr. 6, 2023).

125 15 U.S.C. §§ 78a–78qq.

126 *Id.* § 78s; *Id.* § 78u.

127 17 C.F.R. § 240.10b-5 (2022).

128 Gensler, *supra* note 111.

129 William Hinman, Dir., SEC Div. of Corp. Fin., Remarks at the Yahoo Finance All Markets Summit: Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418. The SEC has now potentially reversed their position regarding ether due to Ethereum's change to a "proof of stake" model; the SEC has taken the position that "staking" crypto tokens qualifies as an investment contract. *See* Lydia Beyoud, *Gensler Raises Concerns Over 'Staking' Model on Ethereum*, BLOOMBERG L. (Sept. 15, 2022, 6:07 PM), https://news.bloomberglaw.com/crypto/gensler-raises-concerns-over-staking-model-used-on-ethereum.

130 Wayne Duggan, *How Does the SEC Regulate Crypto?*, FORBES ADVISOR (June 30, 2023, 9:41 AM), https://www.forbes.com/advisor/investing/cryptocurrency/sec-crypto-regulation.

131 15 U.S.C. § 77b(a)(1).

132 SEC v. W. J. Howey Co., 328 U.S. 293, 297, 301 (1946).

133 *Id.* at 298–99.

hand,[134] but the holding essentially means any cryptocurrency that is not functioning as an equity stake in the enterprise selling that specific cryptocurrency can escape SEC oversight. Cryptocurrencies like bitcoin, which function as unbacked digital currencies, cannot currently be regulated by the SEC.[135] The only realistic way for the SEC to have authority over bitcoin and other non-security cryptos would be for Congress to pass legislation expanding the definition of a security to include all cryptocurrencies or digital assets.

B. SEC Enforcement in the Crypto Market

As previously stated, SEC oversight of the crypto market is restricted to retroactive enforcement actions taken after crypto consumers have already been harmed by a crypto entity's misconduct.[136] Many of the SEC enforcement actions involve initial coin offerings (ICOs), the crypto version of an IPO, where the crypto asset arguably meets the definition of a security but the crypto business fails to properly register their ICO in accordance with SEC guidelines for registering securities offerings.[137] Some of the most notable SEC enforcement actions include: a complaint, currently still being litigated, against Ripple Labs, Inc. for its unregistered ICO of its digital token XRP, the sixth largest cryptocurrency on the market by value, which could have significant implications for what cryptocurrencies qualify as securities;[138]

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[134] *Id.* at 299.

[135] *See* Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11; Maria Garcia Santillana Linares, *How the SEC's Charge that Cryptos Are Securities Could Face an Uphill Battle*, FORBES (Aug. 14, 2023, 7:00 AM), https://www.forbes.com/sites/digital-assets/2023/08/14/how-the-secs-charge-that-cryptos-are-securities-could-face-an-uphill-battle.

[136] *Investor Bulletin: How Victims of Securities Law Violations May Recover Money*, U.S. SEC. & EXCH. COMM'N (June 21, 2018), https://www.sec.gov/oiea/investor-alerts-bulletins/ib-recovermoney.

[137] *E.g.*, Press Release, U.S. Sec. & Exch. Comm'n, Two ICO Issuers Settle SEC Registration Charges, Agree to Register Tokens as Securities (Nov. 16, 2018), https://www.sec.gov/news/press-release/2018-264; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81,207 (July 25, 2017), https://www.sec.gov/about/docket/2017/sec-docket-117-05.xml; *See Crypto Assets and Cyber Enforcement Actions,* U.S. SEC. & EXCH. COMM'N (Dec. 11, 2023), https://www.sec.gov/spotlight/cybersecurity-enforcement-actions. *See generally Cryptocurrency/ICOs*, *supra* note 79.

[138] Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Ripple and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering (Dec. 22, 2020), https://www.sec.gov/news/press-release/2020-338; Cheryl L. Isaac, Keri E. Reimer, Christine Mikhael & Stephen M. Humenik, *CFTC and SEC Perspectives on Cryptocurrency and Digital Assets—Volume I: A Jurisdictional Overview*, K&L GATES HUB (May 6, 2022), https://www.klgates.com/CFTC-and-SEC-Perspectives-on-Cryptocurrency-and-Digital-Assets-Volume-I-A-Jurisdictional-Overview-5-6-2022 ("The final outcome of the Ripple case, whether it will result

an action against BlockFi, a crypto lending company that has now filed for bankruptcy,[139] which resulted in a settlement that required BlockFi to pay multiple fines totaling $100 million and an agreement that the company would cease offering unregistered crypto lending products;[140] a similar $30 million settlement agreement with two entities operating under the trade name "Kraken," for the companies' unregistered sale of their "crypto asset staking-as-a-service program";[141] and multiple other cases involving the SEC charging individuals with running fraudulent, crypto-based Ponzi and pyramid schemes.[142]

Overall, the SEC has imposed over $2.6 billion worth of fines related to securities law violations by crypto companies and has brought 118 enforcement actions against crypto companies in the past five years, compared to 11 enforcement actions prior to 2018.[143] But while many of the SEC press releases involving successful enforcement actions trumpet the need to protect crypto investors by making sure crypto companies are adhering to proper informational disclosures and transparency around their products,[144] these actions do little to help the crypto consumers who have already been hurt by the malfeasance and fraud committed by crypto entities in these cases. Although some U.S. Department of Justice actions have resulted in the seizures of stolen digital assets that can be converted to funds used to provide

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in XRP's classification as a security or not, will have significant implications for the SEC's jurisdiction over digital assets."); Ryan Browne, *Crypto Firm Ripple's Court Battle with the SEC Has Gone 'Exceedingly Well,' CEO Says*, CNBC, https://www.cnbc.com/2022/04/14/ripples-court-battle-with-sec-has-gone-exceedingly-well-ceo-says.html (Apr. 14, 2022, 1:55 PM) (quoting Ripple CEO stating that if the SEC prevails, "most tokens trading on platforms in the U.S. would be deemed securities").

139 Iacurci, *supra* note 98.

140 Press Release, U.S. Sec. & Exch. Comm'n, BlockFi Agrees to Pay $100 Million in Penalties and Pursue Registration of its Crypto Lending Product (Feb. 14, 2022), https://www.sec.gov/news/press-release/2022-26 [hereinafter SEC BlockFi Press Release]. The allegations against BlockFi included unregistered sales, misleading statements to investors, and operating as an unregistered investment company. *Id.*

141 Press Release, U.S. Sec. & Exch. Comm'n, Kraken to Discontinue Unregistered Offer and Sale of Crypto Asset Staking-as-a-Service Program and Pay $30 Million to Settle SEC Charges (Feb. 9, 2023), https://www.sec.gov/news/press-release/2023-25 [hereinafter SEC Kraken Press Release] (noting that Kraken immediately settled with the SEC).

142 *Crypto Assets and Cyber Enforcement Actions*, *supra* note 137.

143 *2023 Crypto Enforcement Trends*, *supra* note 122.

144 SEC BlockFi Press Release, *supra* note 140 ("Adherence to [SEC] registration and disclosure requirements is critical to providing investors with the information and transparency they need to make well-informed investment decisions in the crypto asset space."); SEC Kraken Press Release, *supra* note 141 ("[C]rypto intermediaries, when offering investment contracts in exchange for investors' tokens, need to provide the proper disclosures and safeguards required by our securities laws. . . . Today's action should make clear to the marketplace that staking-as-a-service providers must register and provide, full, fair, and truthful disclosure and investor protection.").

restitution to victims,[145] SEC penalty funds are not paid out to victims unless the court or the SEC issues an order to that effect.[146] For example, part of the $30 million settlement with Kraken is set to go to victims through disgorgement,[147] but none of the $100 million from penalty and fines in the BlockFi settlement is required to go to making victims whole.[148] Additionally, even if crypto consumers who are victimized by fraud are given access to restitution funds, they are likely to receive substantially less value than what they lost and the process for distributing those restitution funds is slow and arduous.[149] With all this in mind, retroactive enforcement action is clearly not the preferable option for protecting consumers when compared to preventative, proscriptive measures.

From the prospective of crypto companies in the market, after-the-fact enforcement from the SEC provides minimal insight into which actions are legal and which are not, leaving these companies in the dark as to what regulatory consequences to expect from their actions. The SEC has provided crypto businesses with written guidance to assist with determining whether or not their crypto token qualifies as a security, but this guidance is just a recitation of the Howey test factors and does not provide crypto businesses with a concrete answer.[150] Settlement results in prior cases, such as the ones already discussed, provide some clarity to crypto companies on what the SEC sees as securities law violations in the crypto space, but as the Ripple Labs case makes clear, crypto market actors may not necessarily agree with the SEC's legal analysis and are willing to incur heavy costs in litigating their position.[151] The result

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[145] *See, e.g.*, Press Release, U.S. Dep't of Just., $56 Million in Seized Cryptocurrency Being Sold as First Step to Compensate Victims of BitConnect Fraud Scheme (Nov. 16, 2021), https://www.justice.gov/opa/pr/56-million-seized-cryptocurrency-being-sold-first-step-compensate-victims-bitconnect-fraud (reporting that $56 million in fraud proceeds were seized from BitConnect and made available to victims of the company's fraud).

[146] *Investor Bulletin: How Victims of Securities Law Violations May Recover Money*, *supra* note 136 (noting that for victims of crypto fraud to receive penalty funds, the court or the SEC must order the penalty funds to be placed in what is called a "fair fund," to be distributed equitably amongst the victims).

[147] SEC Kraken Press Release, *supra* note 141.

[148] *See* SEC BlockFi Press Release, *supra* note 140. The SEC agreed to hold off on collecting $30 million of its settlement from BlockFi until after BlockFi's victims were compensated. Sandali Handagama, *SEC Relinquishes $30M BlockFi Penalty Until Investors Are Repaid*, COINDESK, https://www.coindesk.com/policy/2023/06/23/sec-relinquishes-30m-blockfi-penalty-until-investors-are-repaid (June 23, 2023, 6:41 AM).

[149] *Investor Bulletin: How Victims of Securities Law Violations May Recover Money*, *supra* note 136.

[150] *Framework for "Investment Contract" Analysis of Digital Asset*s, U.S. SEC. & EXCH. COMM'N (Mar. 8, 2023), https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets.

[151] *See, e.g.*, Ryan Browne & Arjun Kharpal, *Ripple CEO Is Optimistic the Crypto Firm Will Get Ruling on XRP Lawsuit Soon, Slams 'Embarrassing' SEC*, CNBC (Jan. 18, 2023, 8:14 PM),

of the Ripple Labs case, one way or the other, may give crypto entities an answer to whether or not they fall under the SEC's registration jurisdiction, but for now both crypto companies and crypto consumers are left guessing about the extent of oversight authority the SEC has in the crypto market.

C. CFTC Regulation of the Crypto Market

The Commodity Futures Trading Commission was first established in 1974 through the passage of the Commodity Futures Trading Commission Act.[152] This act was one of many amendments to the Commodity Exchange Act of 1936 (CEA), which established a regulatory framework for the trading of commodity futures.[153] The Act gives the CFTC "exclusive jurisdiction" over "accounts, agreements . . . , and transactions involving swaps or contracts of sale of a commodity for future delivery."[154] While the CFTC and its predecessors were historically focused on futures trading specifically within agricultural markets, its mission has expanded to encompass broad oversight of all derivatives trading.[155] This enlarged role can be directly attributed to the Great Recession and the subsequent passage of the Dodd–Frank Act, which tasked the CFTC with overseeing the swaps market along with its traditional oversight.[156]

The CFTC's connection to crypto is derived from the definition of a commodity under U.S. Code. A commodity, for the purposes of CFTC authority, is defined as including a long list of products and services along with the general phrases, "and all other goods and articles . . . and all services, rights, and interests . . . in which

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https://www.cnbc.com/2023/01/18/ripple-ceo-optimistic-crypto-firm-will-get-sec-xrp-lawsuit-ruling-soon.html (interviewing Ripple Labs CEO Brad Garlinghouse, who made it clear that he would only be willing to settle the case with the SEC if the SEC agreed that "XRP is not a security," which has led Garlinghouse to commit to a litigation that is now over two years old and is still in the summary judgement phase).

152 Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified as amended at 7 U.S.C. § 4a (1976)).

153 *Id.*; Commodity Exchange Act, Pub. L. No. 74-675, 49 Stat. 1491 (1936) (codified as amended in scattered sections of 7 U.S.C.); *see also Commodity Exchange Act & Regulations*, CFTC, https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm (last visited Jan. 30, 2024).

154 7 U.S.C. § 2(a)(1)(A).

155 Commodity Futures Modernization Act of 2000, Pub. L. 106-554 app. E, § 2(3)–(4), 114 Stat. 2763, 2763A–366 ("The purposes of [the 2000 amendment to the Commodity Exchange Act] are . . . to transform the role of the Commodity Futures Trading Commission to oversight of the futures markets [and] to provide a statutory and regulatory framework for allowing the trading of futures on securities . . . .").

156 Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 701–774, 124 Stat. 1376, 1641–1802 (2010) (codified as amended in scattered sections of 7, 12 & 15 U.S.C.).

contracts for future delivery are presently or in the future dealt in."[157] The CFTC has exclusive jurisdiction over swaps and futures transactions involving anything that falls under this definition for commodities[158] and any futures and swaps contracts involving a commodity can only be traded on a CFTC-approved and registered exchange.[159] The courts have found that cryptocurrencies, as "virtual currencies," qualify as commodities under the "all other goods" and "all services, rights, and interest" language in the statutory definition.[160] The CFTC has also made it clear that it will treat cryptocurrencies as commodities, explicitly stating that multiple cryptocurrencies fall under the definition of a commodity in a recent enforcement order.[161]

Since crypto assets qualify as commodities, the CFTC has full licensing and enforcement authority over any crypto transaction involving derivatives trading or future delivery, and such transactions must follow CFTC regulations.[162] If crypto exchanges want to enter the derivatives or futures trading market, they must go through the CFTC registration process and gain approval.[163] This means the CFTC can bring enforcement actions against crypto entities that deal in futures contracts and fail to register with the Agency, but leaves the CFTC with no licensing authority or prospective oversight over the spot market for crypto.[164] If an exchange only deals in spot trading for crypto, then it can fully bypass CFTC regulations.[165] This is a

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[157] 7 U.S.C. § 1(a)(9).

[158] *Id.* § 2(a)(1)(A).

[159] *Id.* § 6(a).

[160] CFTC v. McDonnell, 287 F. Supp. 3d 213, 225, 228 (E.D.N.Y 2018) (pointing out that commodities can be intangible products and holding that virtual currencies qualify commodities as a good); CFTC v. My Big Coin Pay, Inc., 334 F. Supp. 3d 492, 498 (D. Mass. 2018) (citing *McDonnell* and other CFTC orders in affirming that virtual currencies can be considered commodities).

[161] *In re* iFinex Inc., CFTC No. 22-05, 2021 WL 8322873, at *2 n.2 (Oct. 15, 2021). This order was the result of an enforcement action against crypto exchange Bitfinex who offered and facilitated derivatives trading in cryptocurrencies involving U.S. customers. Bitfinex agreed to cease offering derivative trading in crypto, implement future safeguards to prevent derivative trading from occurring on their platform, and pay a $1.5 million fine. The order included an unambiguous statement that the CFTC believes most major cryptocurrencies qualify as commodities: "Bitcoin, ether, litecoin, and tether tokens, along with other digital assets, are encompassed within the broad definition of 'commodity' under Section 1a(9) of the [Commodities Exchange] Act." *Id.*

[162] 7 U.S.C. § 1a(10)(A)–(B).

[163] Jerry Brito, Houman Shadab & Andrea Castillo, *Bitcoin Financial Regulation: Securities, Derivatives, Prediction Markets, and Gambling*, 16 COLUM. SCI. & TECH. L. REV. 144, 158, 161 (2014).

[164] Isaac et al., *supra* note 138.

[165] Ian McGinley, Enf't Dir., CFTC, Enforcement by Enforcement: The CFTC's Actions in the Derivative's Markets for Digital Assets, Keynote Speech at the Practising Law Inst.: White

significant regulatory hole—arguably the largest regulatory hole in the crypto market—since a cryptocurrency that is only sold on the spot market but does not qualify as a security effectively has no regulatory agency policing it, aside from after-the-fact enforcement for fraud.

Although the CFTC does not have registration authority regarding the spot market for cryptocurrencies, the U.S. Code does grant some general enforcement power to the CFTC over commodities, even on the spot market. As amended by the Dodd–Frank Act, the Commodities Exchange Act gives the CFTC broad enforcement power over the "use or employ, in connection with any swap, *or a contract of sale of any commodity in interstate commerce* . . . any manipulative or deceptive device or contrivance," in violation of CFTC regulations.[166] Based on this authority, the CFTC has promulgated regulations that prohibit market actors from defrauding, manipulating, or deceiving consumers "in connection with any . . . contract of sale of any commodity in interstate commerce."[167]

In at least one published case, the CFTC has successfully brought a fraud action against a crypto entity for activities that occurred exclusively on the spot market.[168] Yet, the court made it clear, in a prior ruling regarding a dispute over jurisdiction, that the CFTC only has this authority "[w]here a futures market exists for a good, service, right, or interest," and the spot market transaction for the qualifying commodity "involve[s] fraud or manipulation."[169] In that same case, the CFTC conceded that the agency does not have any authority over the spot market for cryptocurrencies when fraud or manipulation is not involved.[170] This enforcement power is admittedly significant and can act as a deterrent to crypto entities who believe they can commit fraud on consumers and avoid CFTC action by limiting their fraud to the spot market, but as discussed with SEC enforcement, this remedy is only

Collar Crime 2023, https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcginley1.

166 7 U.S.C. § 9(1) (emphasis added).

167 17 C.F.R. § 180.1(a) (2020) ("It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce . . . to intentionally or recklessly: (1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud; (2) Make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading; (3) Engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit . . . .").

168 CFTC v. McDonnell, 332 F. Supp. 3d 641, 651–53 (E.D.N.Y. 2018). The court ordered a permanent injunction and for the defendant to pay approximately $290,000 in restitution. *Id.* at 726–28.

169 CFTC v. McDonnell, 287 F. Supp. 3d 213, 227 (E.D.N.Y. 2018) ("Where a futures market exists for a good, service, right, or interest, it may be regulated by CFTC, as a commodity, without regard to whether the dispute involves futures contracts. . . . CFTC does not have regulatory authority over simple quick cash or spot transactions that do not involve fraud or manipulation.").

170 *Id.* at 220.

retroactive. Consumers are still left to fend for themselves when navigating the market, unsure of the legitimacy and trustworthiness of the companies they are dealing with due to the CFTC's lack of compressive registration authority over the crypto market.

D. CFTC Enforcement in the Crypto Market

Just like the SEC, the CFTC has recently ramped up its enforcement in the crypto space.

In 2022, the CFTC brought a total of 82 enforcement actions, with 18 of those actions relating to crypto, including one action involving a $1.7 billion fraud scheme.[171] This represented a 73% increase in the amount of crypto enforcement cases brought compared to 2021 and was almost equal to the total amount of cases brought before 2021.[172] CFTC Chairman Rostin Behnam has pointed to 2022 crypto enforcement actions as proof that the agency "continues to aggressively police new digital commodity asset markets with all of its available tools."[173] The CFTC has largely focused these enforcement efforts on crypto exchanges that deal in crypto derivatives but are not registered with the Commission and fraud-related actions.[174]

For example, the CFTC brought a civil suit for fraud against South African national Cornelius Johannes Steynberg and Mirror Trading International Proprietary Limited for running a $1.7 billion multi-level marketing scheme that required participants to buy in with bitcoin, representing "the largest fraudulent scheme involving Bitcoin charged in any CFTC case."[175] The CFTC is seeking disgorgement of the company's ill-gotten gains and full restitution for victims of the scheme,[176] but has explicitly warned these victims that "restitution orders may not result in the recovery of money lost."[177] The CFTC also charged multiple crypto trading platforms with offering leveraged and futures crypto contracts without properly registering with the CFTC.[178] CFTC enforcement actions also included multiple cases

[171] Press Release, No. 8613-22, Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), https://www.cftc.gov/PressRoom/PressReleases/8613-22.

[172] *2023 Crypto Enforcement Trends*, *supra* note 122.

[173] Press Release, No. 8613-22, Commodity Futures Trading Comm'n, *supra* note 171.

[174] *Id.*; Isaac et al., *supra* note 138.

[175] Press Release, No. 8549-22, Commodity Futures Trading Comm'n, CFTC Charges South African Pool Operator and CEO with $1.7 Billion Fraud Involving Bitcoin, (June 30, 2022); CFTC v. Mirror Trading Int'l Proprietary Ltd., No. 22-cv-635, 2023 BL 149711, at *1–3 (W.D. Tex. Apr. 24, 2023).

[176] *Mirror Trading*, 2023 BL 149711, at *20.

[177] Press Release, No. 8549-22, Commodity Futures Trading Comm'n, *supra* note 175.

[178] *See* Press Release, Commodity Futures Trading Comm'n, CFTC Charges Digital Asset Derivatives Platform and Miami Resident with Facilitating Unlawful Futures Transactions, Failing to Register, and Attempted Manipulation of Native Token (Oct. 3, 2022), https://www.

where crypto entities made false or misleading statements of material fact in connection with crypto futures transactions.[179] In 2021, the CFTC charged a group of crypto companies who operated BitMEX, a crypto derivatives exchange, with illegally marketing crypto derivatives to U.S. citizens without first registering with the Commission, resulting in a $100 million judgment.[180]

While actions against companies for failures to register with the Commission do not result in any compensation to consumers who may have been harmed by crypto entities, they encourage other crypto companies involved in the case, or companies following the cases, to follow all relevant regulations. After-the-fact enforcement may result in victimized investors receiving some of their money back, but as the CFTC admits, there is no guarantee losses will be recoverable.[181] Overall, comprehensive registration is the only way to ensure consumers are provided with necessary preventative protections before fraud can occur.

E. Possible Future Legislation Regulating the Crypto Market

The CFTC's authority over crypto markets may change in the near future. During the 2022 session, Congress considered multiple pieces of legislation that

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cftc.gov/PressRoom/PressReleases/8605-22 (charging crypto exchange Digitex Futures with offering futures transactions on a platform not registered with the CFTC); Press Release, No. 8450-21, Commodity Futures Trading Comm'n, CFTC Orders Tether and Bitfinex to Pay Fines Totaling $42.5 Million (Oct. 15, 2021), https://www.cftc.gov/PressRoom/PressReleases/8450-21 (charging crypto exchange Bitfinex with illegally selling digital assets off-market and "operat[ing] as a futures commission merchant (FCM) without registering as required"); Press Release, No. 8590-22, Commodity Futures Trading Comm'n, CFTC Imposes $250,000 Penalty Against bZeroX, LLC and Its Founders and Charges Successor Ooki DAO for Offering Illegal, Off-Exchange Digital-Asset Trading, Registration Violations, and Failing to Comply with Bank Secrecy Act (Sept. 22, 2022), https://www.cftc.gov/PressRoom/PressReleases/8590-22 (charging multiple crypto entities with failing to register with the CFTC and conducting activities only allowable by a registered FCM on a "decentralized blockchain-based software protocol that functioned similarly to a trading platform").

179 Press Release, No. 8540-22, Commodity Futures Trading Comm'n, CFTC Charges Gemini Trust Company for Making Material False or Misleading Statements and Omissions to the Commission (June 2, 2022), https://www.cftc.gov/PressRoom/PressReleases/8540-22 (charging Gemini Trust Company, LLC with "making false or misleading statements of material facts or omitting to state material facts to the CFTC in connection with the self-certification of a bitcoin futures product"); Press Release, No. 8450-21, Commodity Futures Trading Comm'n, *supra* note 178 (charging Tether with making false statements of material fact regarding their stable coin being fully backed by the U.S. dollar reserves held by the company).

180 CFTC v. HDR Glob. Trading Ltd., No. 20-cv-08132, 2021 BL 572683 (S.D.N.Y. Aug. 10, 2021); Press Release, No. 8412-21, Commodity Futures Trading Comm'n, Federal Court Orders BitMEX to Pay $100 Million for Illegally Operating a Cryptocurrency Trading Platform and Anti-Money Laundering Violations (Aug. 10, 2021), https://www.cftc.gov/PressRoom/PressReleases/8412-21.

181 *See* Press Release, No. 8549-22, Commodity Futures Trading Comm'n, *supra* note 175.

sought to grant the CFTC regulatory authority over the crypto market generally, which would include registration authority for the crypto spot market.[182] The Digital Commodities Consumer Protection Act of 2022 (DCCPA) was the leading bill on the matter, introduced by the Senate Agriculture Committee and sponsored by a group of two Democrats and two Republicans, while the Republicans in the House Committee on Agriculture introduced a competing bill, the Digital Commodity Exchange Act (DCEA).[183] The DCCPA would have defined "digital commodity" as "a fungible digital form of personal property that can be possessed and transferred person-to-person without necessary reliance on an intermediary. . . . [including] cryptocurrency or virtual currency, such as Bitcoin and Ether."[184] This definition explicitly excludes securities though, which would allow the SEC to continue to oversee cryptocurrencies that act as securities,[185] while granting the CFTC exclusive jurisdiction over the digital commodities spot market.[186]

The DCCPA would have also instituted a registration requirement for essentially all crypto business actors, granting the CFTC the authority for "mandating consistent, rigorous rules for all [crypto] market participants."[187] These registration requirements would subject crypto market participants to the same regulations applicable for traditional financial institutions and were designed to "protect consumers and empower them to make more informed trading decisions."[188] Upfront registration such as this could help reduce consumer fraud in the crypto space by making sure crypto entities are playing by the rules and assuring consumers know who they are dealing with when making investment decisions. On top of registration requirements, the DCCPA would have required increased policing of fraudulent

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[182] Nikhilesh De, *CFTC Would Become Primary Crypto Regulator Under New Senate Committee Plan*, COINDESK, https://www.coindesk.com/policy/2022/08/03/cftc-would-become-primary-crypto-regulator-under-new-senate-committee-plan (May 11, 2023, 10:09 AM).

[183] *Id.*; Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022); Digital Commodity Exchange Act of 2022, H.R. 7614, 117th Cong. (2022).

[184] DCCPA, S. 4760 § 2(a)(7) (amending the CEA to insert the definition at 7 U.S.C. § 1a(18)).

[185] *Id.* ("The term 'digital commodity' does not include . . . a security.").

[186] *Id.* ("The exclusion [preventing the CFTC from regulating outside the spot market] shall not apply to a commodity transaction that is subject only to Commission antimanipulation, antifraud, or false reporting authority," effectively giving the CFTC registration authority over the crypto spot market.); *see also id.* § 3(2) ("[T]he Commission shall have exclusive jurisdiction over, any account, agreement, contract, or transaction involving a digital commodity trade.") (amending the CEA (7 U.S.C. § 2(c)(2)).

[187] *See id.* at § 2(a)(7) (defining "digital commodity platform," subject to registration authority under § 4 of the Act, as including digital commodities brokers, custodians, dealers, and trading facilities); *see also* S. COMM. ON AGRIC., NUTRITION, & FORESTRY, THE DIGITAL COMMODITIES CONSUMER PROTECTION ACT CLOSES REGULATORY GAPS (2022), https://www.agriculture.senate.gov/imo/media/doc/crypto_one-pager1.pdf.

[188] S. COMM. ON AGRIC., NUTRITION, & FORESTRY, *supra* note 187.

activities associated with cryptocurrencies by prohibiting trading in digital commodities that are "readily susceptible to manipulation"[189] and forcing crypto trading platforms to institute rules and oversight mechanisms to prevent unfair trading practices.[190] While there is ambiguity around the phrase "readily susceptible to manipulation," such a change in oversight within the market would at least represent a step in the right direction for protecting consumers from fraud and market manipulation.

Lastly for this analysis, the DCCPA would have preempted state registration requirements,[191] assuring there was no piecemeal system of state regulations in the crypto market. The bill did not include any protections to address run risk associated with crypto exchanges or establish minimum liquidity requirements for crypto entities, although the bill would extend relevant bankruptcy laws to digital commodity trading.[192] The DCEA, the Republican alternative bill, would have established similar regulatory changes, although with a few key differences, such as a lack of explicit state preemption and not requiring registration with the CFTC.[193]

All this said, neither bill was passed, with both bills failing to make it out of committee.[194] But while both bills remain mere legislative concepts, it is likely these bills, or similar bills establishing comprehensive crypto market regulation, will be considered in future sessions and may eventually pass into law. For this reason, it is important to understand what regulatory concepts are being considered in these bills, what strengths those regulatory approaches may bring, and what improvements could be made to these concepts to assure crypto consumers can feel safe trading crypto. The final Section of this Note will seek to use parts of these legislative proposals, while improving on others, to advocate for what this author believes is the best approach to creating a comprehensive regulatory scheme for the crypto market.

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189 Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. § 4 (2022) (amending the CEA at 7 U.S.C. § 7b-3) ("A digital commodity trading facility shall permit trading only in transactions in digital commodities that are not readily susceptible to manipulation.").

190 *Id.*

191 *Id.*

192 *See id.* § 5(i) (adding "digital commodity platform" to title 11 of the U.S. Code).

193 *Compare* Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. § 4 (2022), *with* Digital Commodity Exchange Act of 2022, H.R. 7614, 117th Cong. § 2(a)(1)(3) (2022); Clark Flynt-Barr, *The Opportunity Before Congress on Crypto Legislation*, CHAINALYSIS (Nov. 1, 2022), https://www.chainalysis.com/blog/opportunity-congress-crypto-legislation.

194 *See S.4760 – Digital Commodities Consumer Protection Act of 2022: Actions*, U.S. CONGRESS, https://www.congress.gov/bill/117th-congress/senate-bill/4760/all-actions (last visited Jan. 30, 2024); *H.R.7614 – Digital Commodity Exchange Act of 2022*, U.S. CONGRESS, https://www.congress.gov/bill/117th-congress/house-bill/7614/all-actions (last visited Jan. 30, 2024).

V. RECOMMENDATIONS

The crypto market is in serious need of a comprehensive regulatory scheme that can provide effective consumer protection and market transparency, while still giving crypto creators the leeway to continue to innovate and bring tangible value to cryptocurrencies as a product. The current system leaves consumers vulnerable to fraud and manipulation,[195] encourages rampant speculation within the market,[196] and gives well-intentioned crypto entities no real guidance on what to expect from regulators.[197] Congress must act as soon as possible to establish a comprehensive regulatory framework for crypto. This framework should first allow the CFTC and the SEC to jointly regulate in the crypto space, allowing the two agencies to continue their enforcement work at a larger scale and with broader authority, while creating a complete registration system covering all crypto entities. Next, an ideal regulatory system would go further than just prohibiting cryptocurrencies that are susceptible to manipulation, instead requiring crypto entities to show that their product has a material utility or value outside of pure speculation purposes. Finally, a comprehensive regulatory system should take the lead from banking regulations and require crypto platforms that hold consumer money to have minimum levels of reserves against their liabilities, along with other creative features to limit risk for crypto consumers and proactively dissuade crypto entities from defrauding their customers.

A. *The CFTC and SEC Regulating Together*

The CFTC and SEC already share enforcement authority within the crypto market. While many proposals for crypto regulation award sole jurisdiction over the market to either the CFTC or SEC, or other agencies altogether,[198] it makes the most sense for the two agencies to share registration authority just as they share enforcement authority. The DCCPA, the leading congressional proposal for crypto regulation, already recognizes the value of continuing to allow the SEC to regulate cryptocurrencies that act as securities, while giving the CFTC general registration authority over digital commodities.[199] This approach fills all the significant regulatory gaps that currently exist in the crypto market by making sure that crypto companies cannot avoid regulatory oversight by utilizing a non-security cryptocurrency exclusively on the spot market. In a dual registration system, a crypto entity must

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[195] *Supra* Sections III.A and B.

[196] *Supra* Section II.A.

[197] *Supra* Section IV.A.

[198] Howard B. Adler & Alex J. Pollock, *Among Six Proposals to Regulate Cryptocurrency, One Is Superior*, THE HILL (Dec. 28, 2022, 2:30 PM), https://thehill.com/opinion/finance/3790612-among-six-proposals-to-regulate-cryptocurrency-one-is-superior.

[199] *See supra* notes 184–186.

be registered with at least one of the SEC or CFTC, and crypto consumers would then have the same access to information and level of protection that they would have when dealing with any traditional investment product.

The crypto industry has complained that current SEC regulations do not provide the industry with enough guidance on what entities are subject to securities laws and has asked for a carveout for crypto companies issuing tokens.[200] As previously discussed, crypto entities generally seek to avoid being classified as securities and subjected to SEC regulation, and have been willing to engage in protracted litigation to accomplish this goal.[201] A dual system assures that even if crypto entities are successful in escaping SEC registration and oversight, they will still be subject to CFTC registration and oversight. Since crypto entities would have to register with either the SEC or the CFTC prior to conducting any crypto offerings or transactions, this approach would also eliminate all "legal" unregistered crypto transactions and make sure crypto consumers are only dealing with registered entities and platforms. Obviously, some entities will still try and operate outside of this legal framework, but such a framework would significantly cut down on black market crypto-dealing and prevent crypto entities from claiming a good faith misunderstanding of what regulations they were subject to. So long as consumers stick to legal, registered trading platforms, they should be just as protected as they would be in any other market.

Critics of the idea to make the CFTC the lead regulator for crypto have argued against the proposal by citing that the CFTC is the favored regulator amongst the crypto industry. These critics argue that the crypto industry favors the CFTC because the Commission is seen as more lenient and less financially ready to take on oversight of the market.[202] While this critique misses the fact that the CFTC already conducts, and has been ramping up, enforcement activities in the crypto space,[203] by allowing the SEC to continue to regulate in the crypto space alongside the CFTC, any potential shortcomings in CFTC regulation can be diminished by the SEC helping to pick up the slack. The CFTC may have a smaller budget compared to the SEC; but Congress can add to this budget with any passage of a crypto regulatory bill and grant the CFTC authority to create revenue-generating mechanisms to increase funding for oversight, for example, through fees charged to the industry.

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[200] *See* Nikhilesh De, *Crypto Doesn't Need More Guidance, SEC Chair Gensler Says*, COINDESK, https://www.coindesk.com/policy/2022/09/08/crypto-doesnt-need-more-guidance-sec-chair-gensler-says (May 11, 2023, 9:57 AM).

[201] *See* Browne & Kharpal, *supra* note 151; Linares, *supra* note 135.

[202] Tory Newmyer & Peter Whoriskey, *Inside Sam Bankman-Fried's Courtship of a Washington Regulator*, WASH. POST (Nov. 28, 2022, 6:00 AM), https://www.washingtonpost.com/business/2022/11/28/sam-bankman-fried-ftx-cftc (noting allegations by consumer protection advocates that "the CFTC is too small, too lenient and less prepared than the [SEC] to undertake oversight of the burgeoning realm of digital currencies").

[203] *Supra* Section IV.D.

Additionally, the CFTC can focus on the relatively small number of cryptocurrencies that aren't considered securities and allow the SEC to focus on the many cryptocurrencies that function as equity stakes in crypto businesses.[204]

A dual-regulatory system could result in the unadvisable situation where crypto companies are effectively choosing their own regulator,[205] but this problem can be easily fixed in the drafting of any regulatory bill. For example, crypto companies could be allowed to apply for registration as either a digital commodity under the CFTC or as a security under the SEC, but then the agencies themselves could be required to approve that application, rejecting the application if they feel the crypto company has incorrectly designated their crypto token as a digital commodity or a security. This determination could be appealable by the company, but this approach would eliminate the need for after-the-fact ligation to decide the issue and assure that crypto companies receive a digital commodity or security designation before undertaking any action in the market that could harm consumers. That way, crypto companies have better upfront guidance and consumers don't have to rely on retroactive enforcement to protect their interests.

The dual-registration system with the SEC and the CFTC working alongside each other arguably provides the most balanced approach to protecting consumers while encouraging further development of the crypto market, but whether this approach is taken or one of the agencies is awarded exclusive registration authority, Congress must act soon. The status quo helps no one. The current lack of regulation will lead to the continued victimization of consumers in the market and will prevent more consumers from entering the market out of overall mistrust and fear of fraud. Crypto purists can argue that decentralization is a core tenet of cryptocurrencies, but it is clear that decentralization has not functioned as intended as far as protecting consumers goes. If the crypto market is going to survive, someone, anyone, is going to need to regulate it. Why not allow the two regulatory agencies that are already seeking to serve that function to continue to do so at a larger and more effective scale?

B. *Prohibiting Pure Speculation Cryptocurrencies*

The DCCPA includes restrictions against trading in digital assets that are "readily susceptible to manipulation,"[206] but this language does not go far enough in preventing cryptocurrencies from being utilized to defraud investors. Although the courts have not had much experience in interpreting this specific phrase, it is

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[204] Bary Rahma, *Distinguishing Securities from Non-Securities in the Cryptocurrency Market*, BEINCRYPTO, https://beincrypto.com/cryptocurrencies-are-not-securities (May 25, 2023, 12:15 PM).

[205] Adler & Pollock, *supra* note 198.

[206] Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. § 5(i) (2022).

present in the Commodities Exchange Act[207] and the Seventh Circuit Court of Appeals has noted that the phrase is ambiguous in at least two cases as there is a question over the interpretation of the word "readily."[208] The Seventh Circuit has noted that susceptibility to manipulation, at least in the futures market, largely depends on the parties' ability to control a significant majority of a commodity's supply.[209] Previously discussed market manipulations and fraud schemes that rely on a crypto entities controlling the supply of a crypto token[210] may be covered by this "readily susceptible to manipulation" language, but the definition of the term "readily" supplies enough wiggle room for a crypto actor to successfully argue that their product is not readily susceptible enough to prevent them from registering as a valid crypto trader.

Instead, future regulatory proposals should strengthen that language by prohibiting the trading of any cryptocurrency that has the sole purpose of financial speculation. This would not only limit the crypto market to products that can at least reasonably claim some material utility or benefit, it would also eliminate the question of manipulation susceptibility, as any cryptocurrency that is readily susceptible to manipulation will not have a material value outside of financial speculation. The crypto market is already seemingly shifting towards an emphasis on utility,[211] and regulation can encourage this move while also doing so in a way that helps protect consumers from potential market manipulation and fraud. This prohibition also would not affect cryptos that act as securities, despite their speculative nature regarding future value, as an equity stake in a business provides tangible value in and of itself. Well-established cryptocurrencies like bitcoin would also pass this test as they have accumulated enough market share to have utility as recognized payment methods and mediums of exchange. While preventing crypto trading that is readily susceptible to manipulation is a good start, fully prohibiting pure speculation tokens would add the extra regulatory strength needed to create a trustworthy

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[207] 7 U.S.C. § 7b–3(f)(3).

[208] Barry v. CBOE Glob. Mkts., Inc., 42 F.4th 619, 623 (7th Cir. 2022) (noting that interpretation of the term "readily" is committed to the CFTC as it is an ambiguous term in the statute); Bd. of Trade v. SEC, 187 F.3d 713, 724 (7th Cir. 1999) (noting that the Court would "take the word 'readily' to signify" "a high probability," while the SEC seems to take the word to mean a mere "possibility").

[209] *Bd. of Trade*, 187 F.3d at 724 ("Squeezes, corners, and other forms of manipulation in futures markets for physical commodities depend on hogging the deliverable supply.").

[210] *See supra* Section III.A.

[211] *See Crypto 2023: A Focus on Real-World Utility*, RIPPLE (Jan. 10, 2023), https://ripple.com/insights/crypto-2023-a-focus-on-real-world-utility ("[M]ost of the expectations for crypto this coming year [2023] involve its application for real-world utility."); *Crypto Winter End in Sight as Ethereum Looks to Shake the Chills—Analysts*, REUTERS (Dec. 12, 2022, 6:45 AM), https://www.reuters.com/markets/currencies/crypto-winter-end-sight-ethereum-looks-shake-chills-analysts-2022-12-12 ("Ethereum and projects focused on real world functionalities and utility are expected to drive the next leg of growth [in the crypto market].").

crypto market that is not driven by speculation and taking advantage of low-information consumers.

C. Other Consumer Protections and Deterrence Mechanisms

Congress can also look to other regulatory schemes for additional creative ways to further protect consumers in the crypto market. For example, a crypto regulatory framework could look to banking regulations to solve run risk issues associated with crypto exchanges. Banks and depository institutions are required to hold a minimum amount of reserve funds against their liabilities under regulations from the Federal Reserve.[212] This same type of requirement could be applied to crypto trading platforms to help prevent situations like recent crypto platform bankruptcies where platforms did not have enough money on hand to pay out customers who had deposited funds in an account with the platform.[213] It's important that this requirement only be applied to crypto trading platforms that are holding customer deposit accounts for trading activity though, as such a requirement does hinder a company's ability to create and reinvest profits and remain viable as a business. This requirement could also be coupled with accounting transparency requirements to prevent future situations like the FTX collapse,[214] and with prohibitions on platforms claiming an ownership right to their customer's money accounts to prevent situations like the Celsius bankruptcy case.[215] A combination of these requirements could go a long way in making sure that the crypto market is not plagued by "runs on the bank" and assure that consumers are in a more favorable position when companies do file for bankruptcy.

Additionally, a crypto regulation framework could utilize an increased statutory or punitive damages scheme to add an extra deterrence mechanism against fraudulent activities. Heightened civil damages provisions can be a tool to discourage bad actors who are not acting in a criminal capacity and crypto regulators could use this tool to further encourage adherence to the registration scheme. The crypto market has already proven to be highly susceptible to fraud with characteristics that are favorable for fraudulent schemes.[216] Congress should take this heightened threat of fraud seriously and add additional statutory or punitive damages provisions into the regulatory framework to strengthen deterrence in the system. Crypto fraudsters utilize the space because it is easy for them to take advantage of consumers due to the lack of regulatory oversight, but the institution of a regulatory system, plus the

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[212] *See* Paul Bennett & Stavros Peristiani, *Are U.S. Reserve Requirements Still Binding?*, ECON. POL'Y REV., May 2002, at 53, 53–54, https://www.newyorkfed.org/medialibrary/media/research/epr/02v08n1/0205bennpdf.pdf.

[213] *See supra* Section III.B.

[214] *Id.*

[215] *Id.*

[216] *See supra* Section III.A.

risk of additional damages if the regulatory system is not followed, could deter many of the crypto frauds that are currently prevalent in the market. Upfront registration and transparency requirements are the most important regulatory actions needed in the crypto market, but increased backend enforcement through heightened damages provisions would help round out a fully comprehensive regulatory system that is focused on protecting consumers and instilling trust in the market.

VI. CONCLUSION

Just as the American Wild West eventually abandoned its lawless roots, the crypto market must abandon its principles against regulation and allow the market to properly develop under needed regulatory oversight. Congress must act as urgently as possible to create and enact a comprehensive regulatory scheme for the market to institute much-needed protections for consumers. This regulatory framework should utilize the two agencies, the SEC and CFTC, who are already providing the majority of enforcement oversight in the market and expand their registration authority over all crypto entities. This regulatory framework should be informed by current issues plaguing consumers in the market, include protections that help prevent crypto frauds from occurring, and put crypto consumers in a better place when fraud or other market failures occur. While cryptocurrencies may prove to be a highly beneficial innovation with practical, real-world value in the future, this goal will never be achieved without an adequate regulatory system to allow the market to grow and develop. If crypto is going to survive, proponents must embrace regulation and Congress must act.