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Gibson Dunn Digital Assets Recent Updates – September 2023

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We are pleased to provide you with the next edition of Gibson Dunn's digital assets regular update. This update covers recent legal news regarding all types of digital assets, including cryptocurrencies, stablecoins, CBDCs, and NFTs, as well as other blockchain and Web3 technologies. Thank you for your interest.

Enforcement Actions

United States

1. ***Feds Charge Tornado Cash Developers Facilitated $1 Billion in Money Laundering***

On August 23, the Manhattan U.S. Attorney's Office brought charges in the Southern District of New York against two developers of Tornado Cash, Roman Storm and Roman Semenov. Tornado Cash is a crypto application that obscures the source of assets transferred through it. Prosecutors allege that more than $1 billion was laundered through Tornado Cash, including hundreds of millions by North Korea's Lazarus Group. Charges include conspiracy to engage in money laundering, conspiracy to violate U.S. sanctions targeting North Korea, and conspiracy to operate an unlicensed money transmitting business. Storm was arrested and released after posting bond. Also on August 23, the Office of Foreign Asset Control (OFAC) sanctioned Semenov and eight Ethereum addresses allegedly controlled by Semenov. **Law360**; **Forbes**; **Indictment**

2. ***SEC Brings First Enforcement Actions Alleging NFTs Are Securities***

On August 28, the U.S. Securities and Exchange Commission (SEC) issued an order simultaneously filing and settling charges against Impact Theory, LLC, a Los Angeles-based media company, related to its sales of non-fungible tokens (NFTs). Applying the *Howey* test, the SEC concluded that Impact Theory's KeyNFTs were investment contracts primarily because Impact Theory's marketing statements promised "tremendous value" and "massive" appreciation. As part of a settlement of the charges, the SEC ordered Impact Theory to disgorge over $5 million. SEC Commissioners Hester Pierce and Mark Uyeda issued a joint dissent from the order, arguing in part that the tokens were not investment contracts because they were not shares of the company and did not generate any type of dividend for purchasers. **Order**; **Law360**; **CoinWire**

Weeks later, on September 13, the SEC issued an order simultaneously filing and settling charges against Stoner Cats 2 LLC (SC2), alleging an unregistered securities offering in the form of profile-picture NFTs. The order states that SC2 raised approximately $8 million from the sale of around 10,000 NFTs to finance the animated web series Stoner Cats, starring Mila Kunis and Ashton Kutcher. In an accompanying press release, the SEC stated that the offering led "investors to expect profits because a successful web series

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could cause the resale value of the Stoner Cats NFTs in the secondary market to rise." SC2 agreed to pay a $1 million fine and destroy all remaining NFTs in its possession. Commissioners Pierce and Uyeda dissented from this order as well, arguing that "the Stoner Cats NFTs are not that different from Star Wars collectibles sold in the 1970s" and that the order "carries implications for creators of all kinds." **Order**; **Press Release**; **CoinDesk**

3. ***CFTC Charges DeFi Platforms Over Crypto Derivatives***

On September 7, the Commodity Futures Trading Commission (CFTC) issued orders simultaneously filing and settling charges against three decentralized finance (DeFi) trading platforms—Opyn, Inc., ZeroEx (0x), Inc., and Deridex, Inc.—for offering digital asset derivatives trading. The orders require Opyn, ZeroEx, and Deridex to pay civil penalties of $250,000, $200,000, and $100,000, respectively, and "cease and desist from violating the Commodity Exchange Act (CEA) and CFTC regulations." The companies were all said by the CFTC to have cooperated in the investigation, getting a reduced penalty as a result. "The DeFi space may be novel, complex, and evolving, but the Division of Enforcement will continue to evolve with it and aggressively pursue those who operate unregistered platforms that allow U.S. persons to trade digital asset derivatives," said Director of Enforcement Ian McGinley. **Release**; **CoinDesk**

4. ***LBRY to Appeal Ruling That It Violated U.S. Securities Law***

On September 7, crypto file-sharing protocol LBRY filed a notice of appeal of a New Hampshire federal court's decision that it failed to register the sale of its native LBRY tokens (LBC) with the SEC. The court's final judgment ordered LBRY to pay a $111,614 civil penalty and barred it from participating in any unregistered crypto securities offerings in the future. "LBRY is appealing the [court's] decision because it is unjust and incorrect," said CEO Jeremy Kauffman. LBRY previously indicated that it would shut down following the July 11 ruling. **Notice of Appeal**; **CoinDesk**; **CoinTelegraph**

5. ***Former FTX Executive Ryan Salame Pleads Guilty Ahead of Bankman-Fried Trial***

On September 7, former top FTX executive Ryan Salame pleaded guilty to one count of conspiracy to operate an unlicensed money transmitting business and one count of conspiracy to make unlawful political contributions and defraud the Federal Election Commission. Salame faces a maximum of 10 years in prison. He also has agreed to forfeit up to $1.5 billion and make restitution of $5.6 million to FTX debtors. His sentencing is set for March 6, 2024. This plea comes less than one month before Sam Bankman-Fried, co-founder of FTX, is set to go to trial on October 2. Salame's attorney previously told prosecutors he would invoke his Fifth Amendment rights against self-incrimination if called as a witness against Bankman-Fried at trial. **CNN**; **Reuters**; **New York Times**

6. ***Former OpenSea Head of Product Receives Three-Month Prison Sentence for NFT Insider Trading***

On August 23, Nate Chastain, the former Head of Product at OpenSea, the NFT trading platform, was sentenced to three months in prison for making around $50,000 by trading NFTs that he knew would be featured on the OpenSea homepage. In May, he was convicted by a jury of wire fraud and money laundering in what is considered the first insider-trading case involving digital assets. Prosecutors had sought a two-year prison sentence, but U.S. District Judge Jesse Furman imposed a shorter sentence based on Chastain's limited profits. Judge Furman also sentenced Chastain to 200 hours of community service following his imprisonment, a $50,000 fine, and forfeiture of 15.98 ether. **Reuters**; **Crypto News**

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Regulation and Legislation

United States

7. ***Treasury and IRS Propose Tax-Reporting Rules for Crypto Industry***

On August 25, the U.S. Department of the Treasury and the Internal Revenue Service (IRS) released controversial proposed regulations governing tax-reporting requirements for the crypto industry. The long-awaited regulations would broaden the definition of "broker" to encompass digital asset trading platforms, payment processors, wallet providers, and "some" DeFi platforms. Under the proposed regulations, starting on January 1, 2025, these entities would be subject to similar tax reporting rules as brokers for securities and other financial instruments. The proposal exempts crypto miners from these requirements. The proposed regulations are open for public comment until October 30. The proposed regulations were criticized by Chairman Patrick McHenry (R-NC) of the House Financial Services Committee as "an attack on the digital asset ecosystem." **Treasury**; **IRS**; **Axios**; **WSJ**

8. ***FASB Announces New Bitcoin Accounting Rules***

On September 6, the Financial Accounting Standards Board (FASB) announced forthcoming accounting rules under which companies that hold or invest in cryptocurrencies will be required to report their holdings at fair value. This would allow companies to recognize gains and losses in cryptocurrencies immediately, as they would with other financial assets. This change is widely seen as an improvement over the current practice of treating cryptocurrencies as indefinite-lived intangible assets. The forthcoming rules include other requirements as well, including that companies must make a separate entry in their financial statements for cryptocurrencies. The accounting rules will be mandatory for all companies—public and private—for fiscal years beginning after December 15, 2024, including interim periods within those years. **WSJ**; **Bloomberg**

International

9. ***UK Crypto Firms Can Apply for Extra Time to Comply with New Restrictions on Crypto Promotions***

On September 7, the UK's Financial Conduct Authority (FCA) announced that UK crypto firms could be given an extra three months to implement new restrictions on crypto promotions. The "[t]ough new rules designed to make the marketing of cryptoasset products clearer and more accurate" are set to take effect on October 8, but can be delayed until January 2024 for otherwise compliant firms to develop the right technical setup. The FCA said that it still intends to take enforcement action against overseas or unregulated firms that continue to unlawfully market to UK consumers starting October 8. **Release**; **CoinDesk**

10. ***Travel Rule Regulation Goes into Force in the UK for Crypto Asset Firms***

On September 1, a new rule requiring crypto firms in the UK to comply with the Financial Action Task Force's Travel Rule went into effect. The UK Travel Rule requires UK-based Virtual Asset Service Providers (VASPs) to collect, verify, and share information on domestic and cross-jurisdictional transactions. According to an FCA statement, crypto businesses domiciled in the UK are required to "comply with the rule when sending or receiving a cryptoasset transfer to a firm that is in the UK, or any jurisdiction that has

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implemented the Travel Rule." If information is missing or incomplete, businesses must make a risk-based assessment before releasing the cryptoassets to the beneficiary. **FCA Statement**; **The Block**

Civil Litigation

United States

11. ***D.C. Circuit Vacates SEC Denial of Grayscale Bitcoin ETF as Arbitrary and Capricious***

On August 29, the U.S. Court of Appeals for the D.C. Circuit ruled that the SEC will have to take another look at Grayscale Investments' application to list a bitcoin exchange-traded product (ETP), because the SEC's rejection of the submission was "arbitrary and capricious" and thus violated the Administrative Procedure Act. The three-judge panel's unanimous ruling was authored by Judge Neomi Rao (a President Trump appointee) and was joined by Judges Edwards and Srinivasan (President Carter and Obama appointees, respectively). The court concluded that the SEC "failed to adequately explain why it approved the listing of two bitcoin futures ETPs but not Grayscale's" proposed spot product, and rejected every rationale offered by the SEC for treating bitcoin spot ETPs differently than comparable bitcoin futures products. "In the absence of a coherent explanation," the court concluded, "this unlike regulatory treatment of like products is unlawful." The court's ruling requires the SEC to reconsider Grayscale's application, but it does not require the SEC to approve the application. **Opinion**; **Law360**; **Barron's**

12. ***Federal Court Dismisses Uniswap Class Action***

On August 30, U.S. District Court Judge Katherine Polk Failla dismissed a class action suit brought against Uniswap and its developers and investors by users claiming that they lost money on scam tokens sold on the Uniswap platform. In dismissing the claims, Judge Failla reasoned in part that "the identities of the Scam Token issuers are basically unknown and unknowable" due to Ethereum's "decentralized nature," and that the plaintiffs' claims therefore were akin to "attempting to hold an application like Venmo or Zelle liable for a drug deal that used the platform to facilitate a fund transfer." Judge Failla also rejected the plaintiffs' claims that Uniswap was liable for the losses under the Securities Exchange Act of 1934, refusing to "stretch the federal securities laws to cover the conduct alleged." In rejecting the securities-law claims, Judge Failla stated in passing that ether and bitcoin are "crypto commodities," potentially suggesting that she believes those assets are not subject to the securities laws at all. Judge Failla also is presiding over the SEC's enforcement action against Coinbase. **Opinion**; **Fortune**; **Bitcoinist**

13. ***New York Federal Court Holds that Electronic Fund Transfer Act Does Not Apply to Certain Crypto Transactions***

On August 11, Judge Lewis J. Liman dismissed a claim asserting that the Electronic Fund Transfer Act (EFTA) applies to cryptocurrency transactions. In *Yuille v. Uphold HQ, Inc.*, No. 1:22-cv-07453 (S.D.N.Y. Aug. 11, 2023), a Michigan retiree sued Uphold HQ, a crypto trading platform and wallet provider, after a hacker drained $5 million from his account. The plaintiff argued in part that Uphold HQ failed to meet the requirements of the EFTA, which imposes obligations on financial institutions to expeditiously investigate and correct errors related to electronic fund transfers. Earlier this year, a different judge in separate suit against Uphold held that the term "electronic funds transfer" in the EFTA was capacious enough to include crypto transactions. *Rider v. Uphold HQ Inc.*, 2023 WL 2163208 (S.D.N.Y. Feb. 22, 2023) (Cote, J.). Instead of resolving that issue, Judge Liman held that the plaintiff's transactions fell outside the EFTA because his crypto wallet was

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not an "account," which is defined under the Act to include only accounts "established primarily for personal, family, or household purposes." Judge Liman held that the plaintiff's crypto wallet account was instead established primarily for profit-making purposes. **Opinion**; **Law360**

14. ***Gemini Earn Customers Could Recover All Funds in New Proposed Renumeration Scheme***

On September 13, bankrupt crypto lender Genesis and its parent company Digital Currency Group (DCG) filed a new proposed remuneration plan. Genesis and DCG stated that, under the proposal, over 230,000 creditors who used Gemini's Earn program "are estimated to recover approximately 95-110% of their claims." Gemini Earn was an investment program implemented by crypto exchange Gemini with financing from Genesis. Gemini Earn customers were affected when Genesis was forced to freeze withdrawals and its lending arm—Genesis Global Holdco LLC—filed for bankruptcy in January 2023. DCG hopes to file an amended version of the proposed plan by October 6, and solicit votes by December 5. On September 15, Gemini issued a statement criticizing the proposed plan as "misleading at best and deceptive at worst." Gemini stated that "[r]eceiving a fractional share of interest and principal payments over seven years from an incredibly risky counterparty . . . is not even remotely equivalent to receiving the actual cash and digital assets owed today by Genesis to the Gemini Lenders." **Proposed Agreement**; **CoinTelegraph**; **CoinDesk**; **Gemini Filing**

Speaker's Corner

United States

15. ***Former SEC Chair Says Spot Bitcoin ETF Approval Is 'Inevitable'***

On September 1, former SEC chair Jay Clayton appeared on CNBC Television to discuss the SEC's deferral of bitcoin ETP applications: "It is clear that bitcoin is not a security. It is clear that bitcoin is something that retail investors want access to, institutional investors want access to, and, importantly, some of our most trusted providers who are fiduciaries or have duties of best interest want to provide this product to the retail public. So I think [spot bitcoin ETP] approval is inevitable," Clayton told CNBC. Clayton's comments follow a federal court's ruling in *Grayscale v. SEC* (discussed above) that there was no justification for the SEC to allow bitcoin futures-based ETPs but deny spot bitcoin ETPs. **CNBC**; **The Block**; **Grayscale Opinion**

16. ***SEC Chair Gary Gensler Testifies Before Senate Banking Committee***

On September 12, SEC Chair Gary Gensler testified before the Senate Banking Committee in an SEC oversight hearing. In his prepared testimony, Gensler maintained his stance that most cryptocurrencies qualify as securities that should be regulated by the SEC: "As I've previously said, without prejudging any one token, the vast majority of crypto tokens likely meet the investment contract test." Gensler also reiterated his strong criticism of the crypto industry: "I've never seen a field that's so rife with misconduct," said Gensler. "It's daunting." The most substantive discussion on digital assets came during questioning from Senator Cynthia Lummis (R-WY), who expressed concerns over Gensler issuing an SEC staff bulletin that would require companies to report customer crypto assets on their balance sheets. Also during the hearing, Chairman Sherrod Brown (D-OH) was highly critical of the crypto industry. "The problems we saw at FTX are everywhere in crypto—the failure to provide real disclosure, the conflicts of interest, the risky bets with customer money that was supposed to be safe," said Brown. Brown also praised the SEC's approach to regulating crypto: "I'm glad the SEC is using its tools to

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crack down on abuse and enforce the law."

Gensler is scheduled to testify next before the House Financial Services Committee on September 27. These scheduled appearances follow mounting criticism from lawmakers over the SEC's approach to regulating crypto, which they argue prioritizes enforcement over providing clear guidance. **Sept. 12 Prepared Testimony**; **Sept. 12 Hearing**; **CryptoSlate**; **CryptoNews**

International

17. ***Chinese Central Bank Official Says China's Digital Yuan Must Be Available in All Retail Scenarios***

During a trade forum in Beijing on September 3, Changchun Mu, the head of the digital currency research institute at the People's Bank of China, said that an essential step for the development of China's digital yuan "is to use digital yuan as the payment tool for all retail scenarios." Although the digital yuan is being tested in pilot regions across China, it remains far from achieving widespread adoption. "In the short term, we can start by unifying QR code standards on a technical level to achieve barcode interoperability," Mu added. Mu's comments follow the Chinese central bank's pledge last year to push for universal QR payment codes. The use of QR code payment systems, dominated by WeChat Pay and Alipay, is already widespread in China. **The Block**; **CoinTelegraph**

Other Notable News

18. ***SEC Defers Decisions on All Bitcoin ETFs***

On August 31, the SEC delayed until October its decisions on all pending applications for a spot bitcoin exchange-traded product, which have been filed by BlackRock, Grayscale Investments, and others. The SEC's decisions come days after Grayscale won a key victory over the SEC (discussed above), which many have viewed as clearing a path for the long-awaited product. **Bloomberg**; **CoinDesk**; **PiOnline**

19. ***Visa to Use Solana and USDC Stablecoin to Boost Cross-Border Payments***

On September 5, Visa announced that it has expanded its stablecoin settlement capabilities with Circle's USDC stablecoin to the Solana (SOL) blockchain. According to its statement, Visa is one of the first major financial institutions to use the Solana network at scale for settlements. "By leveraging stablecoins like USDC and global blockchain networks like Solana and Ethereum, we're helping to improve the speed of cross-border settlement and providing a modern option for our clients to easily send or receive funds from Visa's treasury," said Cuy Sheffield, head of crypto at Visa, in a statement. **CoinDesk**; **The Block**

20. ***Vitalik Buterin Co-Authors Paper on Regulation-Friendly Tornado Cash Alternative***

On September 9, Ethereum co-founder Vitalik Buterin published a research paper that he co-authored with Ethereum core developer Ameen Soleimani, researcher Jacob Illum from blockchain analytics firm Chainalysis, and academics Matthias Nadler and Fabian Schar. The paper proposes a privacy protocol called Privacy Pools. The core idea of the proposal is to allow users to publish a zero-knowledge proof, demonstrating that their funds do not originate from unlawful sources, without publicly revealing their entire transaction graph. The authors argue that this proposal, if implemented, could allow financial privacy and regulation to co-exist. **SSRN**; **The Block**

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21. ***FTX, BlockFi, and Genesis Claimant Data Breached in Cyberattack***

On August 25, Kroll LLC, announced that cybercriminals exposed data belonging to claimants in the FTX, BlockFi, and Genesis Global Holdco bankruptcies following a sophisticated cyberattack directed against Kroll employees. Kroll stated that a cybercriminal targeted a cell phone account belonging to one of its employees "in a highly sophisticated 'SIM swapping' attack." **Law360**; **CoinDesk**

22. ***Ant Group Launches Overseas Blockchain Brand ZAN***

On September 8, Ant Group—the owner of the world's largest mobile payment platform, Alipay—launched ZAN, a new blockchain service aimed at Hong Kong and overseas markets. According to the official press release, ZAN "comprises of a full suite of blockchain application development products and services for both institutional and individual Web3 developers." ZAN will also provide "a series of technical products, including electronic Know-Your-Customer (eKYC), Anti-Money Laundering (AML) and Know-Your-Transactions (KYT), to help Web3 businesses build up their capabilities in customer identity authentication, security protection and risk management." **Press Release**; **CoinTelegraph**; **The Block**

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