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The past two weeks have been big for digital asset issues in courts, with Grayscale winning its appeal to the D.C. Circuit and UniSwap obtaining a dismissal of a proposed class action in front of the same judge hearing the *SEC v. Coinbase* matter. Coinbase Chief Legal Officer Paul Grewal [recently stated](#) “when it comes to protecting the rule of law, the courts remain our last, best hope” in regards to the state of digital asset regulation.

It wasn't all good news for the industry, though. The DOJ brought criminal charges against the Tornado Cash developers, the SEC reached a consent judgment with an NFT issuer, and the IRS issued proposed digital asset reporting rules which could dramatically change how digital assets are exchanged in the United States.

These developments and a few other brief notes are discussed below.

### Criminal Charges Brought Against Tornado Cash Developers: August 23, 2023

**Background:** The U.S. Attorney's Office for the Southern District of New York [has brought criminal charges](#) against [Tornado Cash](#) protocol developers Roman Storm and Roman Semenov for [the protocol's role in allegedly](#) “more than \$1 billion in money laundering transactions” including transactions by North Korean hackers known as the Lazarus Group. The Department of Treasury's OFAC has also [now sanctioned Roman Semenov](#) as a Specially Designated Blocked Person. Roman Storm was arrested in Washington, [while Roman Semenov remains at large](#).

**Summary:** This action raises serious Fourth Amendment privacy concerns as well as First Amendment free speech issues regarding the line between protected speech in the form of creating software code and unprotected actions in deploying or using that software code in allegedly illegal ways. The DOJ criticizes the developers for creating help guides on how to best protect their privacy through the protocol, but also criticize the use of the protocol by sophisticated hackers that do not need assistance with navigating a user interface and can interact with the code directly. Coin Center, which is currently funding [a lawsuit in Florida](#) challenging the sanctions against the protocol itself by

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OFAC, [came out against the criminal charges](#). As stated in [Bernstein](#) “[v]iewed from this perspective, the government’s efforts to retard progress in cryptography may implicate the Fourth Amendment, as well as the right to speak anonymously.” Fellow developer Alexey Pertsev is still [awaiting trial for similar charges](#) on house arrest in Amsterdam.

## **IRS Issues Proposes Rules Regarding Reporting of Digital Asset Transactions: August 25, 2023**

**Background:** [The Treasury Department](#) released its [long-awaited proposal](#) for digital asset reporting obligations. Miners and validators are not required to submit the new Form 1099-DA for reporting non-employment income from digital assets, but most other participants in the transactions will be required to do so. This includes transactions via DeFi, self-custodial wallet providers, and any entity that in any way “facilitates a digital asset sale on behalf of a customer” even if the transaction is peer-to-peer. These proposed rules will now go through the comment and finalization process and would go into effect in the 2025 tax year with “broker” reporting in 2026.

**Summary:** The proposed regulations define “digital assets” and “broker” in ways which would turn website developers into brokers if the websites “facilitate” digital asset sales. These websites are often just appealing user interfaces which allow people to transact directly with the applicable smart contracts. It then becomes an issue of “how helpful is too helpful”? If one website creates the necessary smart contract inputs and initiates a function to do what a person wants, that website would likely be considered a broker. Whereas if another website is doing the same thing, with the exception that the user is copying and pasting the code themselves, that would likely not be considered a broker. The public comment period for the proposed rules is open until Oct. 30, 2023, and many industry groups are expected to weigh in on these proposed rules.

## **SEC Reaches First Settlement for Unregistered Sales of NFTs: August 28, 2023**

**Background:** On August 28, the SEC [brought its first enforcement action](#) against NFT issuer Impact Theory, LLC, charging the company with conducting an unregistered offering of crypto asset securities in the form of NFTs. Without admitting or denying the SEC’s findings, Impact Theory agreed to [a cease-and-desist order](#) and agreed to pay a combined total of more than \$6.1 million in disgorgement, prejudgment interest and a civil penalty.

**Summary:** This is [less about Impact Theory](#) and more about the SEC using a consent judgment to sneak in a new legal theory. This time, the theory is that creator royalties are evidence of a security instrument. [Commissioners Peirce and Uyeda](#) dissented to the judgment, [stating](#) “[w]e do not routinely bring enforcement actions against people that sell watches, paintings, or collectibles along with vague promises to build the brand and thus increase the resale value of those tangible items.” The reality is this: in any form of sale, if an asset is sold in exchange for an investment of money in a common enterprise, and there is an expectation of profit arising from the efforts of a promoter or a third party, that is most likely a security transaction. However, it seems like [the shadow factor of](#) “is this something we traditionally regulate as a security” is grinding away.

## **UniSwap Obtains Dismissal in Southern District of New York Class Action: August 29, 2023**

**Background:** The plaintiffs [in this case](#) had been allegedly defrauded with a number of memecoins that were the subject of rug pulls and pump-and-dump schemes to which the plaintiffs gained

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exposure through Uniswap liquidity pools. Due to Uniswap's decentralized and anonymous nature, the plaintiffs were unable to locate the scam artists and tried to go after Uniswap (or more precisely, the Uniswap Foundation, Uniswap Labs, Uniswap's founder and a couple of investors in the Uniswap ecosystem) instead. The court granted the defendants' motions to dismiss after finding that the defendants didn't have liability under Section 29(b) of the Securities Exchange Act of 1934 or Section 12(a) of the Securities Act of 1933.

**Summary:** Although this is a big win for DeFi, the basis for dismissal had nothing to do with decentralization. Section 29(b) is *usually* used to nullify provisions of agreements that violate securities laws, or entire agreements if the nature of the agreement itself violates securities laws. The court found that the Uniswap smart contract does *not* de facto violate securities laws. Section 12(a) allows for a cause of action against "statutory sellers" of a security, which can include a) someone from whom title to the security transfers and b) someone who promotes the sale of the security for pecuniary gain. The court found that title to the tokens didn't transfer (at least not from the defendants) as a result of Uniswap's liquidity pool mechanics and that the defendants didn't promote the sale transaction, and thus the defendants were not statutory sellers against whom the plaintiffs could bring a cause of action. The court also mentioned several times that if this has created a gap in securities laws, it should be up to Congress to fill that gap. We're not sure there actually is a gap here – plaintiffs could have brought an action against the actual fraudsters; they were just unable to find them.

## **Grayscale Wins Appeal of SEC's Denial of their Application for a Spot Bitcoin ETF: August 29, 2023**

**Background:** Grayscale [won their appeal](#) of the SEC's denial for their Bitcoin Spot ETF product, with a unanimous ruling from a three-judge panel that the SEC's denial was arbitrary and capricious. The Court ruled that [there was no basis](#) for the SEC to claim that a Bitcoin Spot ETF would be any more subject to potential manipulation than the Bitcoin futures ETF which had already been granted by the agency.

**Summary:** [This is more egg](#) on the SEC's face, with three respected judges of differing political backgrounds all looking at the SEC's actions towards a digital asset product and deeming the SEC as acting "[arbitrary and capricious](#)" which is a high standard to meet. It will be interesting if the SEC uses this decision as [a way out of a losing battle](#), or if the agency finds alternative reasons to deny the Grayscale petition along with requests for similar [products from financial giants like Blackrock](#). It is also unclear if this decision will change the agency's stance on the ETH futures ETF, which was [previously expected to be granted](#).

### **Briefly Noted:**

OpenSea "Insider Trading" Defendant Gets Sentenced to 3 Months in Prison: Nathaniel Chastain ("Chastain"), the former OpenSea employee accused of front running purchases of NFTs prior to those NFTs being featured on the OpenSea featured page, [was sentenced to three months in prison](#) after being [convicted of fraud and money laundering](#). [According to the FBI](#), Chastain made roughly \$50,000 "using his knowledge of confidential information to purchase dozens of NFTs in advance of them being featured on OpenSea's homepage...".

Ripple Opposes SEC's Request for Appeal: Ripple filed its opposition to the [SEC's request for interlocutory appeal](#), claiming the SEC's attempt to frame the issue as a purely legal issue rather

than a fact specific application of law to facts

Second Circuit Affirms that Syndicated Loans Are Not Securities: On August 24, the United States Court of Appeals for the Second Circuit, [in a unanimous decision](#), affirmed the prevailing market view that notes representing syndicated loans are not securities. This is a case which the [SEC refused to weigh in on](#), despite being asked to by the Second Circuit. This case is relevant to the digital asset industry regarding tokenized loan products, as well as to the digital asset market as a whole as an example of an asset class with many of the elements of traditional securities but which does not fall under SEC purview. You can read our recent Bitblog post on the decision [here](#).

## Conclusion:

In a rapidly evolving landscape, the past two weeks have illuminated the complexities of digital asset regulation. From Grayscale's landmark appeal to UniSwap's court victory, the digital asset industry has experienced its share of triumphs. However, the criminal charges against Tornado Cash developers, IRS's proposed reporting rules, and the SEC's actions reveal that not all is smooth sailing. These developments have profound implications for privacy, free speech, and the very architecture of decentralized systems.

Paul Grewal's assertion that "the courts remain our last, best hope" is not merely an eloquent statement; it is a sobering reminder that legal engagement is indispensable for the maturation and survival of the digital asset industry. The potential repercussions—whether they concern your tax liabilities, your rights as a developer, or the viability of your investment—underscore the importance of staying abreast of legal developments. Now more than ever, it is crucial to maintain a nuanced, well-informed perspective as we navigate the intricate web of legislation, litigation, and regulatory oversight. Ignorance is not bliss; it's a risk that no stakeholder in the digital asset ecosystem can afford to take.

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