

## **CFTC Wins Default Judgment Against Ooki DAO**

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On June 8, 2023, Judge William H. Orrick of the U.S. District Court for the Northern District of California granted a [default judgment](#) in favor of the CFTC against Ooki DAO, a cryptocurrency decentralized autonomous exchange. The court also permanently enjoined Ooki DAO from operating its website and awarded the CFTC \$643,542 in monetary damages. The court found that Ooki DAO's lack of participation in the litigation and refusal to appear in court contributed to the default judgment. This decision brings to a close the closely-watched case that establishes new precedents for the legal liability of decentralized autonomous exchanges.

### **Background**

bZeroX, LLC operated a blockchain-based software called the “bZx Protocol” (Protocol) from 2019-2021. The Protocol operated on the Ethereum blockchain through the use of smart contracts that allowed anyone with an Ethereum wallet to make investments and bet on the rise and fall of certain virtual currencies. bZeroX, LLC charged fees for access to its technology.

In August 2021, bZeroX, LLC transferred control of the software protocol to “the bZx DAO” which was later named “Ooki DAO.”

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Ooki DAO continued to operate as bZeroX, LLC did, but the CTC alleged it failed to register with the CFTC as required by the Commodity Exchange Act (CEA) for most exchanges that allow commodity derivative transactions. Additionally, Ooki DAO failed to implement a Consumer Information Program (CIP), and failed to conduct Know Your Consumer (KYC) or anti-money laundering procedures. Consequently, the CFTC filed suit against Ooki DAO.

### **Causes of Action**

The CFTC alleged that Ooki DAO violated the CEA in three ways:

(1) Engaging in unlawful off-exchange leveraged and margined retail commodity transactions in violation of 7 U.S.C. § 6(a);

The court found the CFTC sufficiently established this cause of action by showing that the transactions taking place on the Protocol were retail commodity transactions as defined by 7 U.S.C. § 2(c)(2)(D), and that these transactions were entered into on a leveraged or margined basis, and likely to show they were financed in part by the offeror Ooki DAO—subjecting such transactions to the CEA. The court noted:

“The relevant transactions were the ones conducted via the Ooki Protocol, which functionally served as a trading platform where anyone “with an Ethereum wallet” could bet on the rise or fall of certain virtual currencies by contributing collateral currency via smart contracts to open leveraged positions, borrowing virtual currency from the Protocol’s liquidity pool, and exchanging with other currencies. The Protocol user then earned profits or lost their collateral currency based on the actual rise or fall of the other currencies. Users could also open and profit from short positions. Ooki DAO, through its Token Holders, controlled the existence and

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operation of the Ooki Protocol by voting their tokens to take actions such as updating code, pausing and suspending trading, and directing deposits of funds to users.”

(2) Engaging in activities that can only lawfully be performed by a registered futures commission merchant, in violation of 7 U.S.C. § 6d;

The court found that Ooki DAO sufficiently pled that the transactions at issue were retail commodity transactions, and demonstrated that Ooki DAO solicited these transactions via advertising on its public website and social media. Additionally, Ooki DAO did not register as a futures commission merchant, and it is unlawful for anyone to be a futures commission merchant unless registered with the CFTC under 7 U.S.C. § 6d(a)(1). Therefore, the merits of this claim favored default judgment.

(3) Failing to implement CIP, KYC and anti-money laundering procedures in violation of 17 C.F.R. § 42.2.

Under 17 C.F.R. § 42.2, a futures commission merchant must comply with the applicable provision of the Bank Secrecy Act and related regulations which includes implementing a CIP, facilitating KYC diligence, and other requirements such as facilitating an anti-money laundering program. Consequently, the court found that Ooki DAO was in violation of 17 C.F.R. § 42.2 because it failed to implement a CIP, or conduct KYC or money-laundering procedures.

## **Remedies**

The court granted a permanent injunction against Ooki DAO because there was evidence of past and ongoing misconduct that

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established a likelihood that Ooki DAO would continue to violate the CEA if not permanently enjoined.

The court also granted the CFTC's motion to remove Ooki DAO's website, since the website was integral to operating the Protocol and making it accessible to the public. As a result, the court found that shutting down Ooki DAO's website was critical to shutting down the Protocol and preventing the public from accessing the Protocol.

The court further granted the authorized monetary penalties under 7 U.S.C. § 13a-1(d)(1) and 17 C.F.R. § 143.8(b)(1) for each CEA violation, totaling \$643,542 in monetary damages for all three violations in this case.

### **The Court's Analysis**

In order to grant a motion for a default judgment, the court analyzed the circumstances considering the *Eitel* factors. The *Eitel* factors derive from *Eitel v. McCool*, 782 F.2d 1470, 1471-72 (9<sup>th</sup> Cir. 1986). Such factors include: (1) the possibility of prejudice to the plaintiff, (2) the merits of plaintiff's substantive claim, (3) the sufficiency of the complaint, (4) the sum of money at stake in the action, (5) the possibility of a dispute concerning material facts, (6) whether the default was due to excusable neglect, and (7) the strong policy underlying the Federal Rules of Civil Procedure favoring decisions on the merits.

**The Possibility of Prejudice to the Plaintiff:** The first *Eitel* factor was found to favor default judgment because the CFTC was without recourse if their motion was not granted. The harmful effects of a default judgment against Ooki DAO were also found to be *de minimis*.

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**The Merits of Plaintiff’s Substantive Claim, and the Sufficiency of the Complaint:** For the second and third *Eitel* factors, the court found that the CFTC sufficiently pled facts showing Ooki DAO is an unincorporated association under California law and federal law. Therefore, Ooki DAO is subject to suit under the CEA as an unincorporated association, as the CEA assigns liability to any person (including individuals, associations, partnerships, corporations, and trusts).

**The Sum of Money at Stake in the Action:** The court found that the CFTC requesting \$214,514 per violation of the CEA was tailored to Ooki DAO’s specific misconduct, which is what the law authorizes in these circumstances. 7 U.S.C. § 13a-1(d)(1) and 17 C.F.R. § 143.8(b)(1).

**Possibility of Dispute Concerning Material Facts:** The defendant, choosing not to appear in addition to evidence of other settlements where Ooki DAO’s founders admitted to the unlawful operation of their trading platform, demonstrated to the court that the risk of dispute concerning material facts was low.

**Excusable Neglect:** The court found that there was no excusable neglect because Ooki DAO knew about the litigation and the CFTC served Ooki DAO properly. Ooki DAO was found to have intentionally made itself absent from the litigation and court proceedings.

**Policy Underlying the Federal Rules of Civil Procedure Favoring Decisions on the Merits:** Ooki DAO’s decision not to appear or participate favors default because the CFTC would have no recourse without default judgment. Additionally, the trading platform continued to operate at the time this motion for default judgment was granted. Without the default judgment, the CFTC

would have no way to stop the trading platform and protect the public.

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