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BLOCKCHAIN AND THE LAW: RISKS, CHALLENGES, AND OPPORTUNITIES

PANEL II: BLOCKCHAIN REGULATION AND CRIMINAL LAW

JUSTIN C. STEFFEN, MICHELE R. KORVER, ELAINE WYDER-HARSHMAN, MICHAEL BAUMERT, AND EMILY HAYES
MODERATOR: MARGARET RYZNAR

ABSTRACT

The most disruptive technology to emerge in the past decade, blockchain technology has had an immediate impact on the legal industry to address the new issues that blockchain, cryptocurrencies, and distributed ledger technologies present. This panel discusses current and potential regulatory issues facing blockchain technology, including ICOs and securities regulation, prevention of blockchain use in criminal activities, the uncertain tax landscape, and the unique challenges of regulating a global borderless technology.

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PANEL II: BLOCKCHAIN REGULATION AND CRIMINAL LAW

JUSTIN C. STEFFEN, MICHELE R. KORVER, ELAINE WYDER-HARSHMAN, MICHAEL BAUMERT, AND EMILY HAYES

ROBINSON:

Our moderator for the panel is Professor Margaret Ryznar. She is a professor of law and the Dean's Fellow and Grimes Fellow at Indiana University McKinney School of Law. She teaches and researches in the area of family law, tax, and trust and estate. Her scholarship focuses on the rights of family members under federal and state law with particular emphasis on how family members hold and transfer property amongst themselves, including bitcoin. Most recently she's been researching the impact of technology on her field, family law. She's the author of over 75 publications on law, and her work has been featured in the media as well as cited in law journals and other judicial materials.

We have a real treat with us here today for our second panel. Ms. Michele Korver is the Digital Currency Counsel in the Department of Justice Criminal Division, Money Laundering and Asset Recovery Section. She's a subject matter expert on criminal cases involving cryptocurrency, providing legal advice on prosecutorial and forfeiture best practices to government attorneys, investigators, and regulators nationwide. She has over 20 years of law enforcement and federal trial experience and has served with the DOJ since 2003 as an Assistant United States Attorney in Miami, Florida and Denver, Colorado as well as prosecuting hundreds of violations of federal criminal law in U.S. courts with a focus on international criminal organizations, money laundering, drug trafficking, and cryptocurrency.

Sandwiched in between we have Mr. Justin Steffen, a partner at Jenner & Block. He's a partner in the commercial litigation group and is the cofounder and leader of the firm's Fintech and blockchain practices. He routinely represents clients in large, "bet-the-company" litigation, and internal investigations, and assists online lenders and payment companies and blockchain/cryptocurrency companies to navigate the evolving regulatory and legal environment. Justin was recently named as an emerging leader by BAI and a Fintech trailblazer by the National Law Journal.

Next we have Elaine Wyder-Harshman. She she's a partner at Convex Legal where she uses her skills as a security and corporate attorney to help entrepreneurs and artists execute their plans and protect their rights. Her clients hail from a variety of industries from trading and blockchain to tech companies and film. She earned her J.D. degree from the Chicago-Kent College of Law, and after law school served for seven years as an Assistant Attorney General for the State of Illinois in the Civil Appeals Division. Before embarking on her legal career, Elaine did photography, and she is also a coder.

Next we have Mr. Michael Baumert. He's an associate at Barnes & Thornburg and a member of the Intellectual Property Department and Corporate Department. He focuses on technology-driven licensing, mergers and acquisitions, outsourcing, as well as cloud computing. He also has experience with counseling related to data privacy issues and the implementation of the global data protection laws and regulations. He's our GDPR guy today.

And, finally, last but certainly not least, Ms. Emily Hayes. She's the head of blockchain practice at Ziliak Law, and assists law clients organize their businesses, secure capital, comply with relevant laws, and structure their companies in a tax-efficient manner. Prior to joining the Ziliak Law team, she was a Summer Honors Law Clerk at the Enforcement Division of the Securities and Exchange Commission here in Chicago.

MODERATOR RYZNER:

Let me start with a very big-picture question. Is blockchain technology overhyped, or will it actually transform our world and why?

STEFFEN:

I think the answer to both is probably yes. And it's definitely overhyped. I mean, everybody wants to throw the word "blockchain" around to increase their ability to basically earn money. Blockchain is probably a bad application for most things unless you need a decentralized solution. There are good—potentially good—applications, some of which are cryptocurrencies, so I think it will change the world, but it's definitely overhyped. A lot of times there might be a better use for a centralized solution as opposed to a blockchain solution.

KORVER:

So I have to first say this, all of my statements are my personal statements and do not represent the views of the Department of Justice. But I hope that you will still find them informative from the perspective of working at the DOJ. I would agree that I think that blockchain and DLT is overhyped but—and I think in some form or another, it is here to stay. In my world, it's very—we find it is helpful. It is a blessing and a curse because there are so many pluses about it from the perspective of how we can do our jobs to try to stop illicit finance and go after criminals. But on the other hand, there are all these other wonderful particular industry applications in which it's a perfect fit. And I think I would agree with the panelists from the morning that it really depends on what it is that the company needs and what they're trying to do whether or not blockchain is transformative or not.

WYDER-HARSHMAN:

And I agree with what's been said. I think it's ironic that some of the most promising applications of blockchain are taking steps to limit the technology, kind of limiting what some of the proponents think are the best features of blockchain, right, making permission-based blockchains with very limited numbers of nodes with limited access to them, keeping some of the most critical information off the chain so they can preserve privacy. So, yes, this is transformative. Yes, it is overhyped. But I think ultimately its best applications probably will be trading the ideals, the libertarian ideals of the real enthusiasts today. But that doesn't mean it doesn't have a future and it's not valuable.

BAUMERT:

It's not only overhyped, but it's also very expensive. Running bitcoin transactions maybe on our scale these days it still manageable, but studies show that if someone would try to process as many bitcoin transactions as we do any other transactions, the global temperature would rise two percent because of the electricity needed to actually mine all those operations. So it's inefficient, expensive, but again, it doesn't mean that in certain limited solutions it can be transformative.

HAYES:

Yeah, I would agree with everything that's been said so far especially what Elaine said about how some practical uses of it today are sort of going against those libertarian ideals that the founders and the original users of a blockchain system had. With clients in our practice, people usually want to use blockchain or crypto or issue a token because they think it's the big fancy word that will get investors. So, yes, it's overhyped. A lot of people that come in don't understand what they're necessarily asking when they ask for a token offering, and they don't really know how it would actually work. So, yeah, I mean, it has a future, but I'm not exactly sure what that future is yet.

STEFFEN:

I think I want to add one thing. You made a good point, and I think—I hope they covered it this morning, but we all kind of slip into this when we talk about blockchains. We use a very pejorative term, which is "blockchain." Elaine made a good point. One, not every blockchain is the same. Usually the default would be the Bitcoin Blockchain, but it might not even be a technical blockchain. It could be a distributed ledger, the term Michele used. But we're going to use the pejorative I think because we do that, but we're not necessarily referring to the same protocols with the same ecosystem. We're referring to different things sometimes, so they're not all the same. That's an important distinction and a good one.

MODERATOR RYZNER:

Turning to cryptocurrency specifically, which is maybe the most, sort of, pop culture application of blockchain technology, what does a desirable regulatory model for cryptocurrencies look like? Who should lead it? Why? Should we be more focused on the protection of retail investors from scams with the development of an institutional marketplace? Should there be a self-regulatory organization as discussed by bitcoin billionaires, the Winklevoss twins? So what would this regulatory landscape look like, do you think, in an ideal world for cryptocurrency?

KORVER:

From my perspective, it's really about transfer of value, a unit of value that moves from one person to another, one place to another. From the regulatory standpoint, I see it as just another type of financial transaction even though I know that that's not always its use. But if we're just going to specifically talk about cryptocurrency as a unit of value, then I think that we already have in place very robust regulatory regimes here in the United States both statutory for who has authority over it, how you could get yourself into trouble criminally with the regulatory agencies, what their particular laws are, and the enforcement and guidance and also punishments that they can mete out. I think that we actually already have a really good regulatory regime set up here in the U.S. And my opinion is that I wish that we could encourage our international partners to adopt similar types of regimes so that as these things move across borders, which is really one of the beneficial or the big benefits of cryptocurrency in these transactions, the ability to easily move across the world and across legal borders, having some type of similar setup in those countries. That way you're not having folks take their businesses, whether they're a service provider or an exchange that's some type of financial institution, picking and choosing where they're going so that they will be subject to less rigorous regulations because that, unfortunately, defeats the whole purpose of why we have our regulations here in the U.S. So, even though I think it needs to be spread internationally, I'm certainly, even though I'm an American, not the person who says we do everything right, but I think that as far as how we regulate our financial system, we do it pretty well.

WYDER-HARSHMAN:

I would say we have matured regulation, and so while some countries are trying to create brand new systems to regulate crypto specifically, we already—we do have those tools. Now, what could be done better? I think in some other jurisdictions, they have a little more central policy, and that certainly facilitates the development if you're coordinating all the different agencies' positions on cryptocurrencies. And on top of that, we have maybe differences on how states would regulate it here and how the federal government would regulate it, and that is a feature of our system. But if I could see something, I would love to see a little bit more policy coordination among all these players here in the United States, and I think that's something we do have to learn but why we shouldn't jettison the features of a mature system of regulation that work so well.

BAUMERT:

I agree with the panel. I would go even further and say I would even stop legislation on a state level. I think that's not necessarily helpful to have 50 different definitions of what "smart contract" is and what "blockchain" is, and that only brings more confusion to those basic concepts. So let's stick with how the law that we already have and create a federal framework that would work well in interstate commerce.

HAYES:

If I had one wish, it would be that the states could really get on board with money transmission and/or licenses and that regulation. Certain states like Illinois and California—or not California but Texas are—their financial regulators have released statements saying that they will regulate certain types of cryptocurrency activity depending on how you're using it. But then you have New York with a BitLicense[1] which seems to have shut down a lot of cryptocurrency use and the ability for New York residents to engage in sort of a crypto economy whereas other

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[1] State of New York, Dept. of Financial Services, *Virtual Currency Businesses*, https://perma.cc/9MQV-MREU.

states are more receptive to those sort of companies. And it's just frustrating from a legal perspective because it's a lot of work.

STEFFEN:

I want to unpack that a little bit because there was a lot of questions there. I think there's a couple of concepts that I'm hearing my co-panelists hit on, and I agree with them. The first is kind of what's the best way to regulate? And I think you've heard people talk about two different models. I think Elaine mentioned kind of you get some bespoke new technology-focused regulations in places like Japan or Malta. The U.S., kind of as Michele explained, uses existing regulations to kind of regulate a new technology. I do think that, and I agree, I think that the U.S. way is the best, this application-focused way to do it. The only difficulty I think—well, there's a couple difficulties, we heard that too, is that not everybody agrees, and you have conflicting regulation from both states and from other countries. And there are I think—there is at least in some of the space the need to kind of think a little bit more creatively, and that's hard. So think about privacy coins. Think about Monero or Zcash,[2] and how are you going to do AML/KYC[3] on a privacy coin or something that uses a tumbler?[4] I don't know. I have no idea. I don't know if anybody knows. So I'm not saying that we need new laws, but I am saying that we have to be very careful on how we propose guidance.

I think the SEC and the government has generally been very good at putting out enforcement actions and taking kind of deliberate steps to show you. You saw the enforcement actions start with the DAO report, the Rule 21(a) Report and then move to kind of other usually ICO promoters. Then they touched on broker-dealers. They touched on exchanges how they've come back with the decentralized exchange. They're hitting all the different parties, and the CFTC has been involved. You know, I think they're giving good guidance, and I think they're telling us what a lot of lawyers already know is that the same rules apply. But I think that's hard, and it's hard to create a universal. I think that's what everybody is saying. It's hard to create a universal standard, and there's no such body that exists. I think the question hit on should there be an SRO? Good luck getting approval for that. But, you know, what's funny is it's supposed to be a decentralized technology, and it's supposed to kind of be an alternative to traditional modes of governing. And we see the same issues come up, and that is who gets to decide what for whom. Is it disintermediated, or is it truly just adding new intermediators, and I don't think that's been answered. So, there's a lot of problems with creating a global solution. I do think the U.S. solution is—or the way the U.S. is doing it is the best, but only time will tell whether we can work out all these issues.

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[2] *See generally* The Cryptocurrency Consultant, *Monero and Zcash: Two Privacycoins—two worlds*, MEDIUM (Aug. 3, 2019), https://perma.cc/MQU7-3LVH.

[3] *See generally* Dean Steinbeck, *What Every Crypto Project Needs to Know About KYC and AML Regulations*, Crypto Law Insider (Oct. 16, 2018), https://perma.cc/JQE7-WWYV.

[4] *See generally* Ian Allison, *Bitcoin tumbler: The business of covering your tracks in the world of cryptocurrency laundering*, INT'L BUS. TIMES (Feb. 13, 2015, 10:03 GMT), https://perma.cc/X7U5-ZCRS.

MODERATOR RYZNER:

Right, exactly. So who gets to really get the jurisdiction over it, right, and how do we reconcile differences and approaches?

STEFFEN:

I could lead off. I think that's really hard. I mean, the jurisdictional component is pretty much—I think you've seen the U.S. say I don't care where you are. If you're touching the U.S., we got you, and I think that's right. And I think what's interesting, I was thinking about the New York AG's report, and they were looking at potential issues with the different exchanges that had submitted to their investigative demand essentially. And they talked about geo-blocking and how that might not—and they also mentioned kind of VPN detection. These are a couple of things, right? Not every exchange uses those tools. People could be making transactions on exchanges even though they don't look like they are. But that's the problem with the ecosystem is you can tap in from anywhere at any time. I think you're going to have to know that if you're in the space, you're subject to the rules of anybody you touch or reasonably could touch. You've just got to be wary.

KORVER:

I would agree with that. And I can't really speak to the availability for people in a civil context to bring a lawsuit from a jurisdictional perspective, but certainly from an enforcement or a criminal prosecution perspective, it's exactly what you say. Really, it's about looking at what is the conduct? If it is a conduct—if the conduct is either using the cryptocurrency in a primary way to facilitate it, or maybe it's just a way to move money after the fact and the crime has nothing to do with cryptocurrency on the front end, it's really just a tool that is furthering conduct, not always, but in my space and what I'm focusing on, is facilitating conduct that we're familiar with; that we already have codified; that we already have jurisdictional setup for. So I don't really think that from the enforcement perspective, that if you are doing business with any U.S. citizens, potentially if you are putting your traffic through, say, some of the companies, great companies that we have that give web acceleration services and things like that, you potentially just by using a U.S. company potentially could be putting yourself subject to U.S. jurisdiction. And then, of course, we have the law of conspiracy. So if you have folks that you're dealing with in some way, shape, or form here in the U.S. even if you're not physically present there, there is a long arm for the Justice Department and regulatory agencies, particularly Treasury, to come out and to go after folks that they believe are violating the law.

WYDER-HARSHMAN:

I think in some ways it's useful to think of some these cryptocurrency transactions as being very much like cash, right. If you go leave a bag of cash in the park and someone else picks it up, where is the regulation going to be? So, in cash where we see a lot of folks of enforcement is those kind of on-ramps and off-ramps where cash comes in and out of the system, like the Bank Secrecy Act. There are a lot of safeguards for money flowing in and out of banks. I think that's probably the most effective way you're going to see regulation coming out of these cryptocurrency systems too, right; that there probably isn't a solution for the tumblers and that sort of thing, but that really is just an attempt to evade the jurisdiction and the regulation of these on- and off-ramps into the system, right? And in that way, it's going to be—the tumbler is always going to be as suspicious as the duffel bag of cash in the park.

WYDER-HARSHMAN:

I think a lot of these jurisdictional questions are going to revolve around closing down things like that and watching those on- and off-ramps into the system.

BAUMERT:

As the world is getting smaller and we embrace global economies or one global economy, we see more and more regulations that are extraterritorial. And I think that's just a natural development of things that we will try to regulate entities, individuals, even if they are outside of physical borders.

HAYES:

From my experience, I came across one case recently. It was a trademark case where Alibaba Group Holding Company sued a company called Alibabacoin Foundation. The company—or the defendants were—it was a Cayman entity. Alibaba sued Alibabacoin for a trademark infringement in the Southern District of New York. The defendants challenged personal jurisdiction, and they failed because in PJ discovery, they found that Alibabacoin Foundation had on its ledger some e-mail addresses that were—one was traced to a New York resident, and that New York resident transacted I think it was like three or four transactions in Alibabacoin Foundation. And the servers were in Minsk, but that was enough for jurisdiction in the state of New York.[5] So that's one case, but we'll see. It'll be interesting going forward.

STEFFEN:

That's interesting. The two questions you just asked are kind of at odds. Who should regulate or who should take the lead and then jurisdiction. I think what we're all saying is you can be subject to jurisdiction even if you don't want to be. I guess it's kind of not a race to the bottom, but you should know that you're going to be regulated by the most onerous regulations that's out there. So who should lead? I guess whoever's the harshest.

KORVER:

And the strange thing about it is what you were talking about in the beginning, is the purposes that's these technologies were developed with the cypherpunks and trying to decentralize things and keep the government out of our business and our financial transactions is very much one side of it. But then the other side of it is if this is really good stuff, and we want it to flourish, then you want to push the bad actors out of the space and therefore you need the regulation in order

[5] Alibaba Group Holding Ltd. v. Alibabacoin Found., 18-CV-2897 (JPO), 2018 WL 5118638 (S.D.N.Y. Oct. 22, 2018).

to do that so that the people that are going to be successful and follow the law and not cause harm in whatever way it may come across are more successful.

MODERATOR RYZNER:

Incidentally, one of my former practices was FCPA, so it was sort of similar where you took out a checkbook if you wanted to do business, and you just wrote DOJ checks because you knew you were in violation probably. Similarly here, just pull out your checkbook if you want to do bitcoin business and be prepared to pay the fines because depending on how harsh we take an approach towards regulation of it. So zooming in a little bit more on bitcoin and its role in money laundering, what are the concerns here and what are the regulatory steps that can be taken, and does the law need to go any further to protect against money laundering?

STEFFEN:

I think Elaine kind of answered this pretty well earlier is that—and I think if you look at studies, and I don't know how much I believe—I used to spend a lot of time on CryptoTwitter, and it's hard to really parse out the good from the bad there. But you see a lot of money laundering still occurring at regulated financial institutions, large banks, and the reports are that it's at a much higher incidence than bitcoin, for instance. Bitcoin is only pseudoanonymous as opposed to fully anonymous, and they've done a decent job, I think, of being able to trace bitcoin transactions. You see Chainalysis or Elliptic being able to kind of associate bitcoin wallets, so those are good tools.[6] There is a possibility, I suppose, of money laundering. That's true with cash, too, as Elaine said. My duffel bag full of cash in the park, it's really hard to say where that comes from. The rules are in place. They're good. And I think by targeting the intermediaries, or targeting the on-ramps as Elaine mentioned, is the best way to kind of target that is my two cents.

KORVER:

I would agree. Unfortunately, not everybody who's out there in this space involved in some form of money laundering is using bitcoin. A lot of them are now moving to the privacy coins that, although there are some cryptocurrency exchanges that are taking those and use kind of an account holder verification model of meeting their obligations for AML and your customer. Even though maybe you can't see where the transaction is coming in from and where it's going on the other end, because it's not on a public blockchain, but at least identifying when it does come in, here is who it belongs to and we're looking at that person from the rough space model. So for bitcoin, you know, less of an issue, but the AECs, the Anonymity Enhanced Cryptocurrencies or privacy coins, those are the things that we're most concerned about.[7] As well as the tumblers and mixers, which, again, prevent both law enforcement and those folks that have obligations under the Bank Secrecy Act to know where the money is coming from and going. There's just no way even in a public blockchain to follow that. So that creates a problem. And then I would say the

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[6] *See generally* Jeff John Roberts, *To Catch a Bitcoin Thief, Call These Detectives*, FORTUNE (Jun. 27, 2018), https://perma.cc/E32W-M58W.

[7] *See generally* Neal B. Christiansen and Julia E. Jarrett, *Forfeiting Cryptocurrency: Decrypting the Challenges of a Modern Asset*, 67 DOJ J. FED. L. & PRAC. 155, 180 n.8 (2019).

third issue that we run into with money laundering, so if they're doing it like the traditional money laundering that you see either in the banks or certain offshore type of companies or real estate or whatever, there's still the record and the data and the evidence to collect so that you can do your job.

But what crypto and even bitcoin allows you to do is move money completely outside of those systems in a way that I don't think you can do as effectively with other types of financial instruments. And even with cash because of just physically how much room it takes up, you know, a million dollars, if it's in cash as opposed to a QR code to a QR code on a phone in a Starbucks where there's free wi-fi. The peer-to-peer activity that occurs, which is one of the coolest things about this technology is really actually one of the most difficult things that law enforcement faces because then you're not being led to some company where you can subpoena the records and see, okay, we saw that this transaction that we know is dirty went to this particular wallet. Who has control of the wallet? From a money laundering perspective, you look at it traditionally the way you always would because there are these financial institution type of service providers that operate the same way as the companies that we've always—and the banking industry that we've always been familiar with. But on the other side of the coin, you have all these new ways of using it which makes it much harder to see what's going on.

MODERATOR RYZNER:

And then "smart contracts" was mentioned earlier today, so where do you see the market going in smart contracts? Are they viable? What has been your area of expertise with smart contracts?

BAUMERT:

So we talked about the smart contract this morning, but just to refresh your recollection, these are just computer scripts that run on blockchain, Ethereum specifically, but also other blockchains are looking to adopt it. These are typically if-then statements. So if a condition happens, then something is being conducted, including transfer of ownership rights to digital assets or assets overall. I see a lot of applications for smart contracts; although, smart contracts are probably not the most accurate name for these scripts. Many believe that smart contracts would allow for machine-to-machine commerce to permit machines to conduct some sort of commercial transaction with another machine without the involvement of a human or a third party. And applications are sort of boundless. It could be a refrigerator re-ordering milk. It could be a charging station of a vehicle conducting some sort of transaction with the vehicle. So I am optimistic. I think that as soon as the language that the smart contract are being written becomes fully object orientated, it will allow for more complexity as we have right now.

MODERATOR RYZNER:

I don't want to monopolize these illustrious panelists, so I'm going to now open it up to you to see if there are any questions at this point from the audience.

AUDIENCE QUESTION:

Do you guys foresee the growth of cryptocurrency continuing to the point where it will take place—the majority of transactions will take place in crypto? And if so, how soon over what period of time do you think that would happen?

BAUMERT:

With the current technology we have, I don't think that's going to happen because simply bitcoin is inefficient. It's too expensive. It's too slow. You have to wait sometimes hours but for the entire transaction to perform. So we need something much more efficient for a broader application.

KORVER:

Can I pose a question to you, then, related to that? So what about the lightning network and that's supposed to be able to accelerate payments, use less energy. Do you think that some of these newly minted or coded networks for processing transactions, mining, are going to fix that, or do you think that they're going to have the same types of issues?

BAUMERT:

I think eventually they will all meet the same obstacles. Meaning as the number of transactions substantially grows, distributing countless databases amongst millions of nodes is too time-consuming.

STEFFEN:

I would say to both questions—Michele gave a good disclaimer. I should have given one too, but I'll give one now. Nothing I say reflects the views of my partners, and nothing I say is investment advice. If you ask me for investment advice, that would be a bad decision. I have no idea what the future of crypto is. And I think that, like a lot of people, I was surprised at how fast it kind of came upon us, and I have no idea where it's going. A lot of people make the analogy to the internet age. I don't know if that's a fair one, but I do think it's fair in one respect. No one knew whether Netscape was going to be the winner or no one knew that Google was going to come on the scene. The same way here. Is Bitcoin going to be the coin de jour? A lot of people that were anti bitcoin a while ago are now bitcoin maximalists. I have no idea if some other cool, new coin that has a good functionality, doesn't use a proof-of-work system or has some sort of proof-of-work system that's more easily scaled, I have no idea if any of this will ever exist. It's hard to say, and I think anybody that tells you they know, doesn't, is full of it. So that's my two cents.

KORVER:

And I would agree from a very different context. I think we were talking about this before. When I first started working in this space about five years ago, the things that we would talk about on the panel and the things that as I was still prosecuting cases at that point and not at Main Justice, laying in bed at night, not able to sleep, thinking, oh, my God, how are we going to write this warrant? How are we going to stop this? And very quickly, and sometimes slowly, the technology really changed and evolved such that we were able to solve our problems, and that on the panels we were talking about completely different things. So now it's all about ICOs. Those didn't exist just a couple of years ago. I think moving forward in some digital way for transfer of value, I think absolutely will continue. Whether it's cryptocurrency in the form that we see it right now I think is probably not going to be the case.

WYDER-HARSHMAN:

I would add, I think it's largely going to be a political question, too. Do we want something that's untethered from the government to be our store of value, like gift cards or something. But even those are denominated in dollars now, right, terms of value. So even if you solve all the technological problems, does anyone really want something that's not backed by the government? Well, yes, if you're in certain countries, yes, the government has failed. Their money has failed, and you might use bitcoin. But as long as the western nations are stable, that's a big question. Why would you want to abandon the connection with government?

REYES:

I wanted to pick up on this thread that we use the same tools to find the bad actors that we've always done. But now the problem with the Chainalytics and things that people are moving to deeper, more private transaction methods. Do you think that that is a problem or trend more broadly, and if so, what does that mean for regulators, right? The idea being that as soon as regulators regulate and figure out what to do with the technology at one stage, it pushes decentralization so that the folks decentralize to a further and greater extent, the point of which is to make it harder to regulate, right. So is there a place that which regulators need to find the optimum level of regulation such that you're preventing further negative externalities in terms of pushing further decentralization? Does that question make sense? Basically, is it partially the regulators' fault? That's kind of the question.

KORVER:

I wouldn't say it's somebody's fault, but I would say yes to what you're proposing. And even in the context of competition, I talk to some of these folks in the industry, entrepreneurs, who will complain and say, well, why aren't you shutting these people down faster? Why aren't you doing something? We are following all of the rules in trying to do what's legally right, and we are getting lapped by all these other people who are just moving to this jurisdiction or doing that. So, I mean, I think it's multifaceted, and one does drive the other. But it depends on I guess what your perspective is and what is your responsibility in the role that you're in.

STEFFEN:

I don't think this is unique to cryptocurrency or blockchain either. I mean, scam artists and fraudsters have always been quick to adopt technology throughout time. Does that mean that regulators can't come in or they should be doing it faster? I think that's really hard to do. But I think, like in all things, if you use a little common sense, if you get that ICO e-mail that I get 20 times a day, you know, use your head.

REYES:

I would just say there's, like, caution in labeling them all scammers and con artists because there are legitimate businesses who just have a philosophical bent that will be pushed further towards decentralization than not in response to hard-line regulatory perspective. So, the question is, can regulators actually create negative externalities that make this worse?

KORVER:

Yes. But, unfortunately, we have this job to do. And so we have to protect people from all of the evils that are out there whether it's investor protection or whether it's trying to stop crime. And so that is going to—that is the fallout of it.

STEFFEN:

Yeah. I think it would be really hard to have kind of a nuance subtle regulation for every different company and every different application. It's just not possible. There's going to be people that maybe are doing the right thing, they aren't scammers, but the regulations will have a deleterious effect on their business. Okay. Well, that's the world. That's why you pay for lobbyists. I'm not a lobbyist.

KORVER:

And why you will all have lots of business. Because as they said earlier, it's a very gray world, and it's constantly changing, and lawyers are needed to figure these things out.

STEFFEN:

I usually make that plug.

HAYES:

I agree with what Justin said. I mean, it happens across the board. You'll see it with people moving across the border and immigration law. If you build a wall, the border just became harder to cross. And drug cartels took over the movement of people instead of your traditional "coyotajes." So it's not a problem that's unique to blockchain and crypto. And it's the cost of working in startup and doing business. You're going to have to overcome that somehow. I think the regulators are trying to work with people. You have the SEC and the CFTC have like Fintech labs, so they want to be friendly and try to be helpful, but that's life. Life's not fair.

REYES:

Given the tenor, right, that this is going to be how it happens, is there an argument for requiring regulators to do this through an open, sort of, notice and public comment process more so than through guidance and speeches as has been happening to date? I mean, if that's the, "Oh, well," then should they get a say?

HAYES:

I mean, yeah, right. I was at a speech over the summer given by the head of the OCIE, correct me if I'm wrong. He finally said that bitcoin and ether are not securities.[8]

STEFFEN:

It was Hinman. He's the head of Corporate Finance.

KORVER:

Hinman. Yeah, he actually isn't a Commissioner.

HAYES:

That was said in a speech. So it would be nice if that was, I don't know, written down.

KORVER:

I will tell you from a prosecutor's perspective, that would be helpful for us as well because a lot of times when there is legislation or policy coming through in this space, what will happen is all the different agencies will make their rounds of comments. For me, my clientele, when say a piece of legislation comes, are the prosecutors. What is going to help them do their job, or what are you going to put in this that's going to create defenses or make it harder for us to do our jobs? A lot of times the other agencies will say, oh, but we have this, that, and the other. And I said I can't go into court and argue to a judge that that's not binding on them when you have to prove beyond a reasonable doubt that a person is guilty of element one, two, and three which is delineated in a statute that Congress has passed. So, I mean, it would be helpful for us as well if it went through the process and was something that was more than persuasive on a judge. It was actually something that could be used as a prosecutorial tool or maybe even in a civil type of dispute where a judge is not just kind of randomly making decisions. They actually have some type of meatier legal basis that they can make their decisions.

WYDER-HARSHMAN:

But I wonder where the balance is between once you are to the notice and comments stage, you're locking it in, and that makes it really tough. I am frustrated, too, just the vague pronouncements and that they'll tell you, okay, you can't do this. But then you don't find out until they start enforcing it what they really think. That's such a risk, right? The people who end up taking the risk are—well, they're the people who are reckless sometimes. You know, they're the ones that get caught, and they make the law. That's not the best way to make law. But where do you strike that balance of knowing when you're ready for the finality of notice in common goal making? I don't know. I don't have an answer on that. Does anybody?

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[8] William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), https://perma.cc/T5RT-6VLC.

STEFFEN:

No, I agree with you. I think the hard thing is that there's a certain—I mean, we're lawyers. I think we made this point. We live in gray. That's what we do all day. That's how we make a living. It's almost impossible I think at some point to have some rules made. That's what I was trying to get at earlier. You can't have a rule for every situation. It's really hard to work that way. So when you get things—and they always disclaim, I'm very good at disclaimers too, but it's their personal views. But when Hinman said that ether is sufficiently decentralized so therefore, no longer—not that it was never—but no longer a security, how are you supposed to apply that test? I don't know. How do you apply how we test anyway? It's three factors that are pretty vague and you use them anyway. How do you know what's an unfair deceptive trade practice? I don't know. I could argue both ways on everything. There's a certain imprecision that's inherent in the language, and I think it's impossible for rule making, as well informed as it is, to address all the inherent problems with that. That's just the English language in every situation. You can't trust everything.

WYDER-HARSHMAN:

But at some point it does come down to that. And in a civil law system, they will get there faster, I think, right? Well, maybe not faster but—yes.

STEFFEN:

The speed of litigation versus the speed of regulation, it's an interesting race. I don't know. That's a good question.

AUDIENCE QUESTION:

Is there any move in the industry toward sort of a self-certification model or self-regulation to avoid the sort of slow-moving regulatory process where industry moves obviously a lot faster so they can respond to changes in technology, changes in behavior? Is there anything like that in the works—because I understand the libertarian bent and the very independent-minded origins of it—but they are becoming an industry, and eventually lobbyists and it will sort of congeal. Is there a move towards self-regulation?

KORVER:

I hear a lot of talk about it, but I couldn't speak as to the specifics. Industry, I think wants that, and they're starting to take steps to try to do those types of things, but I don't think it's very far down the road.

STEFFEN:

At least with respect to the crypto community, I think you hear a lot of people want that, a lot of talk. Just like there's a lot of talk around crypto ETF and things like that, but I don't see a lot of movement on these things. And I think there are parts of this ecosystem where you get a little bit more kind of—you see it in the IP space with the kind of open-source protections and how they deal with that. But you need a pretty large critical mass of people in the industry to actually get together to do that. Like in most industries, not everybody's interests are aligned. Just look at the bitcoin protocol, for instance. Miners and developers don't necessarily have the same ideas in mind, and that leads to governance issues. So, I think that would be really hard to see anything in the near future, but maybe they'll get there.

MODERATOR RYZNER:

I think you can self-certify some new products on the futures market, and I think that's how bitcoin futures got into trouble a little bit. They self-certified and then the rest of the futures industry was very nervous about what that would mean for the rest of them. So, I think it allows innovation like you point out, self-certification, but it might increase your risk with new products and things like that. It's a constant balancing act.

AUDIENCE QUESTION:

Can you folks speak about the tax law enforcement aspects of bitcoin?

WYDER-HARSHMAN:

We know the things we generally talk about, some of the risks. There are the questions, you know, when you—and this is not my original example, but if you use bitcoin to purchase a cup of coffee at Starbucks, and it's worth more than you paid for the—the bitcoin is worth now more than it was originally, are you going to have to report the capital gains that you realized when you bought the coffee? That's an issue. There have been cases where people have publicized their wild purchases on the internet, and the IRS has taken notice and come after them. So there are those kinds of tax issues. There are also a lot of cross-border transaction tax issues, right? We have FACTA who reported the requirements for funds that are overseas that have U.S. citizens' money, how to start enforcing that with cryptocurrency transactions and cryptocurrency holders. So those are some of the big tax issues I think. That's the broad outline. Any other broad ones?

BAUMERT:

Well, I know that some believe that the money, the millions or billions of dollars gathered through ICOs is taxable income, and companies should pay their share.

AUDIENCE QUESTION:

Is the Treasury accepting bitcoin as payment?

STEFFEN:

I don't think so.

WYDER-HARSHMAN:

Other issues, State taxes. What if your cryptocurrency keys are lost? So technically you own it. The State owns a lot of cryptocurrency, but you can't recover it. What does that mean, then?

STEFFEN:

I will caution that if you are on the coin base ecosystem or at least you were, and you had a significant volume of transactions, it might be wise to declare them.

Because they do have your information now that they subpoenaed the top 20,000 account holders for bitcoin or something like that. The IRS knows where the information is held, again, the intermediaries. And they believe I think that any sort of crypto-to-cash transaction or any sort of sale, even crypto-to-crypto would be a taxable event.

STEFFEN:

I think they officially have information on that. I'm not a tax lawyer. It's not legal advice.

AUDIENCE QUESTION:

Have you noticed significant increase in criminal activity now in cryptocurrency, and if so, is it harder—is it getting harder and harder to find them, to catch them, is it getting easier? And then, is it more in the exchanges or more just in the general transaction of cryptocurrency, like commercial transactions?

KORVER:

Yes, no, and all of them. But, again, there is certainly a lot of noncriminal activity out there involving cryptocurrencies. It's a great tool. It's a great tool for people to use not only to hide who they are, their identities, but also to conceal the assets, like the proceeds of the crime afterward. It's hard for me to determine whether there's such an increase or whether we just are paying more attention to it, and we're better trained, and now we're prosecuting and investigating more stuff. I would say what I have personally seen an uptick in is crimes that have absolutely no cyber type of element to it, have nothing to do with the Darknet and drug trafficking and buying illegal things on the dark markets. We've seen a real increase in just traditional fraud and other types of crimes where then cryptocurrency is used in some step later on to conceal the proceeds. So that would be an increase that we've seen.

ROBINSON:

I'm curious, and this is mainly directed at Michele, and I don't know if you can answer this question or not. But are we seeing organized criminal syndicates operate using cryptocurrency or moving into the space? Are we seeing nation states that are utilizing cryptocurrency to evade sanctions or things like that? I'm assuming those issues are on the DOJ's radar or on the government's radar in general. How much of that is existing versus just a potential threat out there?

KORVER:

So, yes, it is on our radar. So an example that's publicly available of what we call the transnational criminal organizations' use of cryptocurrency, say, for their money laundering purposes or moving it across borders are these drug-trafficking organizations that operate on the Darknet on these markets or have their own websites down with access via Tor.[9] That's the primary method of payment and

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[9] Press Release, Dept. of Justice, Office of Public Affairs, *Attorney General Announces Results of J-Code's First Law Enforcement Operation Targeting Opioid Trafficking on the Darknet*, No. 18-397 (Apr. 3, 2018), https://perma.cc/WUF9-G7VE.

money movement and facilitation of the organization's tasks. I think from that perspective, there have been lots of prosecutions of those types of cases. Certainly groups that still think it's okay to talk to each other on the telephone to conduct their business are going to be the same types of organizations that aren't necessarily going to adopt this technology very quickly. But I think it's only a matter of time that this use, if this is still in the form that it is in now, will get adopted more widely by criminal organizations.

AUDIENCE QUESTION:

The cryptocurrency or the blockchain have the decentralized feature, but there is the transactions between the bitcoin and U.S. dollar and other currencies. So if it has the connection with this kind of transaction that exists there, does this destroy the blockchain's decentralized feature?

STEFFEN:

Because people are trading U.S. dollars or other currencies for bitcoin? I don't think so. I think the decentralization, at least from the bitcoin blockchain, is built on the kind of mining and transaction validation network. It doesn't make it less decentralized by adding in a layer of fiat to crypto. I'm not sure if that answers the question or not.

MODERATOR RYZNER:

I never thought about it that way, but that's definitely an interesting interaction between currencies. But I tend to agree; that it probably doesn't subtract too much from the decentralized nature.

AUDIENCE QUESTION:

In sort of other tech platforms we've seen a series of incidents regarding from anything like Cambridge Analytica and election tampering to data breaches to use to sort of plan crimes. We've seen a series of incidents like this lead other type of platforms change their tone from, no, we can handle ourselves. We can regulate our own business, to, you know, maybe federal regulation is not such a bad idea. What kind of incidents do you see pushing kind of the blockchain and these operators and these sorts of platforms to change that, to change from their current position to maybe something like that in the future?

STEFFEN:

Money. I mean, regulation isn't necessarily bad, right, and clear regulation is sometimes a good thing. Regulation is also good if you have an economic advantage or closer ties to the regulators than other people and want to eliminate your competition. I don't think everybody views regulation as bad. I think most people welcome it. I think most crypto and blockchain companies welcomed it, too, but I don't think wanting or desiring more regulation was anything other than people wanting to do things the right way.

MODERATOR RYZNER:

Regulation definitely adds legitimacy, right, to whatever is being regulated.

STEFFEN:

Yeah, I think it's interesting. When you see a lot of crypto companies or blockchain companies starting, they want to be in the U.S. Partially because of the mere opinion or wide-held view that if you're in the U.S., you're doing things the right way because it's the most strict. I'm not saying that that is the correct view, but I'm saying that is a view held by a lot of people, and I've heard that espoused by many; that, well, if you're in the U.S., you're doing it right, so you're probably on the up and up. Is that true? I don't know.

MODERATOR RYZNER:

Same as stocks. You want to get listed on the American Stock Exchange because you know there's a level of regulation that makes it legitimate. The Coffee theory, Professor Coffee out of Columbia.[10]

WYDER-HARSHMAN:

So, yeah, and if you want to have institutional investors starting to invest in your company, that's essential too. So maybe that's the payoff for people is get us access to those institutional investors by gaining more legitimacy. What drives it at the other end, adopting regulation, is when you have disasters like losing large amounts of money like Mt. Gox or what happened with the fork in Ethereum. I mean, they kind of recovered. But when you start to see—and with the smaller cryptocurrencies, the altcoins, this happens all the time where they have a 51 percent attack or something, and some other group comes in and takes over the blockchain, and now you've lost that money. So it's those kinds of incidents on the other end that push people into accepting regulation I think.

KORVER:

On the other hand, if you look at those examples, you really don't need new regulation. That goes back to my old argument. If you have a hack, it's a hack, it's a theft. There is a criminal violation for that. It's stealing just via this method. So, certainly for protecting consumers who may be using these products, maybe there is regulation because if you are going to be holding custody for folks, you have to have this level of insurance or you have to have some type of bonding to protect, you know, the funds that you're holding for folks in crypto. Those maybe are regulations that they're willing to open up to because it actually allows them to say, hey, come bring your business here. We're trusted and if something does happen, we have this parachute.

AUDIENCE QUESTION:

Are you noticing more financial institutions and investment banks investing more in cryptocurrency, trying to gain like a larger percentage of their assets in cryptocurrency?

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[10] *See* Margaret Ryznar, *Regulating Bitcoin: A Tax Case Study*, MACHINE LAWYERING (May 29, 2019), https://perma.cc/K552-VHHD.

STEFFEN:

I don't know about their individual investments. I think you see a lot of traditional financial institutions interested. I mean, Goldman Sachs has always been rumored to have a trading desk, and you saw the Fidelity thing. I think the one issue that is very difficult for a lot of these things is a valuation question. For instance, if you're going to get a custodian, how do you value the cryptocurrency to know how much it has to be insured up to? I think that's a really difficult question. What method are accountants going to use to actually value this stuff? And especially thinly-traded assets as opposed to something like bitcoin which might be a little bit easier. It would be very difficult.

DEAN SORKIN:

When I think back, I didn't invest in bitcoin because I got burned by E-gold. But I think back to what I think of as predecessors of bitcoin and other cryptocurrencies, and what distinguishes bitcoin, as far as I'm concerned, is mostly the gimmicks attached to it, the idea of mining your own to make money and the trendiness of it. The distributed ledger which, yes, is part of how it works, but is also a gimmick just like using BitTorrent as opposed to posting files on a website. Sometimes that makes more sense, but often people just do it so they can say they're doing it. E-gold's gimmick was that you were investing in bullion, even though the function of it, other than for people using it illicitly for money laundering, was just to enable microtransactions with extremely low transaction costs. And until eBay banned E-gold as a payment method because it competed with their own PayPal, it was a lower cost way to buy and sell on eBay and had other advantages for sellers like irreversibility, nonrepudiation, and so on.[11] PayPal had its own gimmicks when it came out. Originally it was advertised as being permanently free because they were going to make their money from the float until they realized that nobody was going to leave money sitting in a PayPal account. Credit cards, you know, to go back not just 10, 15 years, but 20 years of e-commerce, credit cards, which are still used widely, have fairly high transaction costs, though I think bitcoins are even higher, at least for small transactions. But all of these things have the potential of being used for virtually costless, very small amount, microtransactions or small-level transactions, and yet none of them really are doing that well.

And people are reluctant to give access to the real money in their real bank account for online transactions too. Especially in the U.S. there seems to be more resistance to that. And in the U.S. more than anywhere else we have this fallback that we love cash. We use ATMs to get our money not because we use it to keep track of our electronic funds but because we actually want physical money. We use that to pay for things less so than the past. But it's got a lot of the advantages that we are always looking for in cryptocurrencies and other electronic currencies like at least some limited amount of privacy and a store of value and so on and, of course, without the volatility of bitcoin and other cryptocurrencies now. In the future, are we going to be able to get all of those things aside from the gimmicks from cryptocurrencies or other electronic payment mechanisms, or is that just a dream?

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[11] *See generally* Carla L. Reyes, *Moving Beyond Bitcoin to an Endogenous Theory of Decentralized Ledger Technology Regulation: An Initial Proposal*, 61 VILL. L. REV. 191, 203-6 (2016).

STEFFEN:

I don't know. It's hard to—like I said, it's hard to—if I was a prognosticator, it'd be great. I'd be rich, and I wouldn't be sitting here, no offense to you all. I think the problem with that is you alluded to a number of different concepts and the different ways that certain kinds of tokens or cryptocurrencies are used, and can some of them have actual use cases and be useful like your E-gold was or PayPal was and I guess is? Perhaps. I mean, people want to use Ripple to do a money transaction.[12] What you think of Ripple, I don't know. But could it work? Maybe. Are there problems with the Ripple ecosystem? Yeah. I think you could have this. Will it exist? Will we work through the issues and get there? History tells you we tend to move forward as opposed to backwards, so I would think so. But in what time frame, I don't know. And what will that currency look like? I don't know. Will it have a proof-of-work system or a proof-of-stake or a proof-of-burn or a distributed proof-of-work? I have no idea. Those are all fun. I like the chart.

BAUMERT:

I think the very nature of bitcoin or blockchain is to be volatile because there is no central authority who can pull the switch or press the button and make things work. I don't really know how we can possibly prevent that or somehow limit it. There are stable coins, but we'll see how that goes.

AUDIENCE QUESTION:

Are there considerations you have to take when submitting blockchain evidence to court? How have the courts dealt with evidence collected from blockchains in the past few years as opposed to the traditionally-gathered evidence presented?

KORVER:

We haven't really had to deal with that yet. Thankfully there has been just overwhelming evidence of other traditional evidence that has been used for convictions where people went to trial. We haven't had any cases go to trial where we've had to rely primarily or completely on blockchain technology. I'd say when Ross Ulbricht was prosecuted, the administrator of the Silk Road in New York, certainly there was tracing that was done on blockchain in order to show the transactions for purposes of him having control over wallets. It was used for attribution evidence that he in fact was the administrator, among other things. But it wasn't the only thing that they were relying upon. It was just one little piece in a lot of different evidence put together, and there was no legal challenge about the authenticity. I don't believe there were any *Daubert* hearings at all about the technology. It was really presented in a way that you would see in any case where you have to show a financial transaction that X went from here to there and it belongs to Y. It's an excellent question. As a trial attorney, I love those questions because those are the things that we're thinking about, and as we go forward with prosecutions, we know there will be cases where that type of evidence is going to be presented. And we are super excited about meeting that challenge.

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[12] Marcel T. Rosner and Andrew Kang, *Understanding and Regulating Twenty-first Century Payment Systems: The Ripple Case Study*, 114 MICH. L. REV. 649 (2016).

STEFFEN:

I will tell you that we are doing just such an event, a mock trial using blockchain evidence on the 6th with Lisa and some other folks in the audience just to show you how difficult or challenging it can be. There will be challenges, but like we've talked about before, the same rules apply. You can do it, but you're going to have to be very deliberate about it.

WYDER-HARSHMAN:

I should say from talking to you and Lisa and enough people, I understand that sometimes this is still a point of negotiation. If you haven't reached the level of being in court, if you're just talking to the Agency, yeah, there are these issues of what is enough evidence? So if I'm advising clients, if they are dealing in bitcoin as a medium of exchange, try to stick with those forms where you can document what happened. You know, Coinbase has high fees, but you've got the advantage that they're recording where the money is going and who's sending it more than some other places that you might just exchange your bitcoin directly.