

BARLEY TO BITCOIN: THE SCOPE OF CFTC AND NFA JURISDICTION OVER SPOT DIGITAL ASSETS

*By Susan Gault-Brown, Peter Hong,
and Christian Lee**

For the past several years, the Commodity Futures Trading Commission (CFTC) has been asserting jurisdiction over spot transactions in digital assets, an approximately \$1.19 trillion market.¹ Neither the Commodity Exchange Act (CEA) nor the rules promulgated under the CEA by the CFTC define the term “digital asset” or terms such as cryptocurrency, virtual currency, digital currency, coins or tokens.² Notwithstanding the lack of an explicit grant of authority over digital assets in the CEA, the CFTC bases its jurisdiction over digital assets in the scope of the CEA’s definition of the term “commodity.” If a digital asset is a “commodity,” then spot transactions in that digital asset fall within the CFTC’s spot commodity jurisdiction. The CFTC’s spot commodity jurisdiction is comprised of the CFTC’s anti-fraud and anti-manipulation authority³ and the CFTC’s broader authority with respect to leveraged, margined or financed spot commod-

ity transactions with non-eligible contract participant counterparties.⁴

This article examines the CFTC’s jurisdictional claim over spot digital assets as well as the regulatory authority over spot digital assets of the self-regulatory organization, the National Futures Association (NFA). Part I discusses enforcement actions and litigated cases in which the “commodity” definition has been applied to digital assets and the scope of such applications. Part II examines the scope of the delegated authority of the NFA and its recent efforts to regulate spot digital assets transactions of NFA members.

I. CFTC’S CLAIM OF JURISDICTION OVER SPOT DIGITAL ASSETS

As stated above, if a digital asset is a “commodity,” then spot transactions in that digital asset fall within the CFTC’s spot commodity jurisdiction. The term “commodity” is defined in CEA Section 1a(9) as follows:

The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, pea-

*Susan Gault-Brown and Peter Hong are partners and Christian Lee is an associate at Stradley Ronon Stevens & Young, LLP.

nuts, soybeans, soybean meal, livestock, livestock products and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13-1 of this title) and motion picture box office receipts (or any index, measure, value or data related to such receipts), and all services, rights and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.

The definition is broad, covering just about everything one can think of, including goods, services, rights and interests (but excluding onions and motion picture box office receipts) that have a futures contract traded on them. It is this breadth that provides the CFTC with its claim to jurisdiction over digital assets. What follows is a brief overview of the CFTC's jurisdictional position and how courts have reacted to date.

In 2015, the CFTC concluded in the context of an enforcement action and settlement that Bitcoin should be treated as a commodity. In *In the Matter of: Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*,⁵ which involved Bitcoin options, the CFTC stated, without any analysis, that CEA Section 1a(9)'s broad definition of "commodity" encompassed "Bitcoin and other virtual currencies." The CFTC did not address the commodity definition requirement that a commodity must have "contracts for future delivery [that] are presently or in the future dealt in." At the time *Coinflip* was settled, there were no digital assets futures contracts. Subsequent to the *Coinflip* action, in December 2017, the Chicago Mercantile Exchange (CME) began offering trading in Bitcoin futures.⁶

Nearly three years after *Coinflip*, in 2018, the

U.S. District Court for the Eastern District of New York took a more detailed look at the scope of the CEA's commodity definition in *CFTC v. McDonnell*.⁷ In *McDonnell*, the defendants were alleged to have engaged in a deceptive and fraudulent digital assets scheme involving Litecoin. Addressing the defense's contention that the CFTC lacked jurisdiction, the court noted that "[w]here a futures market exists for a good, service, right, or interest, it may be regulated by CFTC, as a commodity, without regard to whether the dispute involves futures contracts." However, the court did not further inquire as to whether a futures market did, in fact, exist. While Bitcoin futures existed in 2018 at the time of the court's decision, futures contracts in Litecoin did not exist (and still do not exist in the U.S.), and it was not clear that futures on one digital asset necessarily drew all digital assets into the CEA's "commodity" definition.

This question was addressed shortly after *McDonnell* by the U.S. District Court for the District of Massachusetts in *CFTC v. My Big Coin Pay, Inc.*⁸ In *My Big Coin*, the CFTC alleged defendant falsely induced customers to buy a digital asset called My Big Coin by artificially changing the price of the digital asset to make it appear that it was being actively traded. The defendant argued that My Big Coin did not meet the "commodity" definition because there were no My Big Coin futures contracts. The CFTC countered that because of the existence of futures contracts on one digital asset (the Bitcoin futures contracts), all digital assets, including My Big Coin, fall within the commodity definition. The court agreed with the CFTC that the CEA defines "commodity" generally and categorically rather than "by type, grade, quality, brand, producer, manufacturer or form."

To support its interpretation, the court looked to a series of natural gas cases in which the courts involved “rejected arguments that a particular type of natural gas was not a commodity because that specific type was not the subject of a futures contract.” Importantly, the *My Big Coin* court recognized the following:

[T]he courts held that because futures contracts in natural gas underlaid by gas at Henry Hub, Louisiana, were dealt in, *and because natural gas is “fungible” and may move freely throughout a national pipeline system*, this was sufficient to show that natural gas, including the types at issue in these cases, was a commodity (italics added).

Based on the example of natural gas, the *My Big Coin* court appears to have concluded that Bitcoin and My Big Coin were categorically the same, both being digital assets. But arguably, there are salient differences between various kinds of digital assets, such as Bitcoin and My Big Coin, including the underlying technology, the proposed use, and the asset design. Given this, the court’s decision represents a very broad reading of the term “commodity.” The breadth of the interpretation was acknowledged by the court to be aligned with Congress’ goal of “strengthening the federal regulation of the . . . commodity futures trading industry, . . . since an expansive definition of ‘commodity’ reasonably assures that the CEA’s regulatory scheme and enforcement provisions will comprehensively protect and police the markets.”

To date, while other courts have cited the above analysis, no other courts have examined the issue.

II. THE SCOPE OF NFA’S JURISDICTION AND RECENT NFA DEVELOPMENTS

The NFA, widely known as a self-regulatory organization, is also definitionally a registered futures association. Section 17(o) of the CEA authorizes the CFTC to delegate registration functions to one or more registered futures associations, and Section 17(p) requires any such registered futures association to establish:

- Training standards and proficiency testing for associated persons and their supervisors;
- Minimum capital, segregation and other financial requirements for association members;
- Minimum standards governing members’ sales practices; and
- Special supervisory guidelines to protect the public interest relating to the solicitation of new accounts.

Pursuant to this authority, the CFTC has delegated certain of its registration functions to the NFA, as set forth in CFTC Rule 3.2.

The scope of the CFTC’s delegation to the NFA expressed above reads as though it is limited to the registration of members and associated persons, member financial requirements and sales practice requirements. However, the CFTC’s expression of its delegation authority is set forth more broadly in CFTC Rule 170.1:

Since a basic purpose of a futures association is to regulate the practices of its members, an association should demonstrate that it will require its members to adhere to regulatory requirements

governing their business practices *at least as stringent as those imposed by the Commission* (italics added).

The broad scope of the CFTC’s delegation is similarly reflected in the purpose section of the NFA’s Articles of Incorporation, in which the purpose of the NFA is described, in part, as “undertaking the regulation of persons that are members of NFA.”

Reflecting the scope of the CFTC’s delegation of authority to the NFA and consistent with the CFTC’s actions above, the NFA has taken a number of actions with respect to its members’ spot digital asset activities. Notably, in 2018, the NFA published Interpretive Notice 9073, “Disclosure Requirements for NFA Members Engaging in Virtual Currency Activities.”⁹ Under Interpretive Notice 9073, NFA members are required to provide specific disclosures to their customers in connection with spot digital asset transactions as well as commodity interest transactions. With respect to spot transactions, the NFA is clear in the Interpretive Notice that it does not have any jurisdiction or authority: “NFA’s Board of Directors is concerned that market participants may not understand that NFA does not regulate in any manner an FCM or IB Member’s activities with customers or counterparties involving underlying or spot virtual currencies.” Nevertheless, the NFA proceeded to require the following disclosures with respect to spot digital assets both in the futures commission merchant/introducing broker context and in the context of commodity pool operators and commodity trading advisors. For example, the NFA requires this disclosure by CPO and CTA members: “Virtual currencies . . . have unique features and present some potentially significant risks that warrant enhanced disclosures to pool participants and managed account

clients,” and requires additional disclosures regarding the following topics (as expressed by the NFA): the unique features of digital assets; price volatility; valuation and liquidity; cybersecurity; the opaque spot market; exchanges, intermediaries, and custodians; the regulatory landscape; technology; and transaction fees.

The Interpretive Notice also mandates the following specific disclosure by CPOs and CTAs, presumably with respect to pools and accounts subject to NFA oversight:

[NAME OF NFA MEMBER] IS A MEMBER OF NFA AND IS SUBJECT TO NFA’S REGULATORY OVERSIGHT AND EXAMINATIONS. [NAME OF NFA MEMBER] HAS ENGAGED OR MAY ENGAGE IN UNDERLYING OR SPOT VIRTUAL CURRENCY TRANSACTIONS IN A [COMMODITY POOL OR MANAGED ACCOUNT PROGRAM]. ALTHOUGH NFA HAS JURISDICTION OVER [NAME OF NFA MEMBER] AND ITS [COMMODITY POOL OR MANAGED ACCOUNT PROGRAM], YOU SHOULD BE AWARE THAT NFA DOES NOT HAVE REGULATORY OVERSIGHT AUTHORITY FOR UNDERLYING OR SPOT MARKET VIRTUAL CURRENCY PRODUCTS OR TRANSACTIONS OR VIRTUAL CURRENCY EXCHANGES, CUSTODIANS OR MARKETS. YOU SHOULD ALSO BE AWARE THAT GIVEN CERTAIN MATERIAL CHARACTERISTICS OF THESE PRODUCTS, INCLUDING LACK OF A CENTRALIZED PRICING SOURCE AND THE OPAQUE NATURE OF THE VIRTUAL CURRENCY MARKET, THERE CURRENTLY IS NO SOUND OR ACCEPTABLE PRACTICE FOR NFA TO ADEQUATELY VERIFY THE OWNERSHIP AND CONTROL OF A VIRTUAL CURRENCY OR THE VALUATION ATTRIBUTED TO A VIRTUAL CURRENCY BY [NAME OF NFA MEMBER].

However, even with respect to pooled vehicles and accounts for which NFA does not have oversight—for example, a fund invested solely in spot digital assets—the NFA has mandated the following disclosure:

[NAME OF NFA MEMBER] IS A MEMBER OF NFA AND IS SUBJECT TO NFA'S REGULATORY OVERSIGHT AND EXAMINATIONS. HOWEVER, YOU SHOULD BE AWARE THAT NFA DOES NOT HAVE REGULATORY OVERSIGHT AUTHORITY OVER UNDERLYING OR SPOT VIRTUAL CURRENCY PRODUCTS OR TRANSACTIONS OR VIRTUAL CURRENCY EXCHANGES, CUSTODIANS OR MARKETS.

Interestingly, the Interpretive Notice does not define what it calls “virtual currencies” and does not address the issue of whether or not such assets are “commodities” subject to CFTC (and therefore NFA) jurisdiction.

Notwithstanding Interpretive Notice 9073 and other NFA reporting disclosure requirements, until recently, the NFA did not have any rule that substantively addressed its members' spot digital asset activities. As a result, if an NFA member engaged in fraud or similar misconduct involving spot digital asset activities, the NFA may not have possessed the authority to discipline the member or take any other similar corrective action. As expressed by the NFA, with “[w]ell over 100 NFA Members [reporting] to NFA that they engage in business activities related to digital assets, both in commodity interest and spot markets,” the NFA perceived a gap in its ability to oversee spot digital asset markets—something the NFA viewed as “untenable.”¹⁰ The NFA addressed this perceived regulatory gap by adopting NFA Compliance Rule 2-51 in 2023. Compli-

ance Rule 2-51 imposes new requirements on NFA members and their personnel that engage in what the NFA now terms “digital asset commodity” activities—currently limited by the NFA to activities involving Bitcoin and Ether. The rule—approved by the CFTC—expressly authorizes the NFA to require its members engaging in spot digital asset commodity activities to adhere to specific business conduct standards in such dealings.

Compliance Rule 2-51 imposes new anti-fraud requirements, just and equitable principles of trade obligations, disclosure requirements and supervisory responsibilities on NFA members and their personnel in connection with spot digital asset commodity activities, as described below. Under the NFA's anti-fraud requirements, NFA members and their personnel engaging in activities involving any digital asset commodity must avoid: (i) cheating, defrauding or deceiving any other person involved in those activities; (ii) making a communication related to a digital asset commodity that operates as a fraud or deceit; (iii) willfully making or causing to be made a false report or record in or in connection with any transaction involving a digital asset commodity; (iv) disseminating false or misleading information that affects the price of any digital asset commodity; (v) engaging in manipulative acts or practices regarding the price of any digital asset commodity and (vi) embezzling, stealing, or purloining any money, securities, digital assets or other property received from or accruing to any person in connection with a transaction involving a digital asset commodity.

In addition, the just and equitable principles of trade portion of Compliance Rule 2-51 requires members and associated persons to “observe high

standards of commercial honor and just and equitable principles of trade in the conduct of their business involving any digital asset commodity.”

Compliance Rule 2-51 also imposes the disclosure requirements set forth in Interpretive Notice 9073, which means that any member of the NFA engaging in spot digital asset commodity activities *must* abide by the enhanced/additional disclosure requirements discussed above. As noted, NFA members engaging in spot digital asset activities must prominently display language in their materials that explicitly indicates that the NFA does not have regulatory oversight authority for underlying or spot market digital asset products or transactions, or digital asset exchanges, custodians, or markets.

The supervisory requirements of Compliance Rule 2-51 require each NFA member engaged in digital asset commodity activities to “diligently supervise” its employees and agents in the conduct of their digital asset commodity activities for or on behalf of the member and requires similar responsibilities for associated persons with supervisory duties.

The NFA has limited the scope of Compliance Rule 2-51 to only two digital assets—Bitcoin and Ether, which clearly are commodities because, as noted, they have related futures contracts certified for listing. In the release accompanying Compliance Rule 2-51, the NFA notes though that it could amend the rule in the future to cover additional digital assets that are identified as “commodities.” In light of the NFA’s evolving definition of “digital asset commodity,” which is expressly tied to the CEA’s definition of “commodity,” NFA members engaged in digital asset activities should take note of CFTC actions in

which the CFTC identifies additional digital assets as commodities.

CONCLUSION

Recently, in March 2023, the CFTC filed a complaint in the U.S. District Court for the Northern District of Illinois against Changpeng Zhao and three entities that comprise the Binance platform with willful evasion of federal law and operating an illegal digital asset derivatives exchange.¹¹ In its complaint, the CFTC identified several digital assets, including Litecoin, Tether, BUSD as commodities, notwithstanding the fact that futures do not trade in the U.S. on Litecoin, Tether, or BUSD.

It remains to be seen if the *Binance* court will agree or disagree with the *My Big Coin* court about the extent to which different digital assets should be treated the same as different types of natural gas. If so, then all digital assets are already “commodities” under the CEA definition, and the CFTC clearly has spot commodity jurisdiction over them. However, if not, if all digital assets are not the same, are not “fungible,” then the CFTC’s current jurisdiction over spot digital assets may be limited to Bitcoin and Ether.

ENDNOTES:

¹¹The global market cap for “cryptocurrencies” as of May 26, 2023, was \$1.17 trillion. See <https://www.coingecko.com/>.

²In recent enforcement actions, the CFTC defines the term “digital asset” to mean: “anything that can be stored and transmitted electronically and has associated ownership or use rights. Digital assets include virtual currencies that are digital representations of value that function as mediums of exchange, units of account, and/or stores of value.” See, e.g., *CFTC v. Changpeng*

Zhao, Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited, and Samuel Lim, Complaint filed on March 27, 2023, in the U.S. District Court for the Northern District of Illinois.

³See Section 6(c) of the CEA.

⁴See Section 2(c)(2)(D) of the CEA.

⁵CFTC Docket No. 15-19, 2015 WL 5535736 (Sept. 17, 2015).

⁶The only other digital asset futures currently trading in the U.S. are Ether futures, which launched on CME in February 2021.

⁷*Commodity Futures Trading Commission v. McDonnell*, 287 F. Supp. 3d 213, Comm. Fut. L. Rep. (CCH) P 34222 (E.D. N.Y. 2018), adhered to on denial of reconsideration, 321 F. Supp. 3d 366, Comm. Fut. L. Rep. (CCH) P 34289 (E.D. N.Y. 2018).

⁸*Commodity Futures Trading Commission v.*

My Big Coin Pay, Inc., 334 F. Supp. 3d 492, 495-96, Comm. Fut. L. Rep. (CCH) P 34345 (D. Mass. 2018).

⁹NFA Interpretive Notice 9073, October 31, 2018, available at <https://www.nfa.futures.org/rulebooks/rulebooks/rule.aspx?Section=9&RuleID=9073>.

¹⁰See National Futures Association, Proposed NFA Compliance Rule 2-51: Requirements for Members and Associates Engaged in Activities Involving Digital, Asset Commodities, February 28, 2023, available at <https://www.nfa.futures.org/news/PDF/CFTC/030223-Proposed-CR-2-51.pdf>.

¹¹See *CFTC v. Changpeng Zhao, Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited, and Samuel Lim*, Complaint filed on March 27, 2023, in the U.S. District Court for the Northern District of Illinois.

