

Cryptocurrency: The Coin of the Future?

By John M. McNichols, *Litigation News* Associate Editor



Originally conceived as a medium for daily consumer transactions without the need for banks, credit cards, or paper money, “cryptocurrencies” have proven remarkably successful over their short lifespan. Bitcoin, the most widely known cryptocurrency, launched in 2009 at less than \$0.01 per unit. Four years later, its price per unit crossed the \$1,000 threshold, and by end of 2020, it had reached \$24,000.

Other virtual currencies, such as Ethereum and Litecoin, have charted similar trajectories. Sovereign governments, which historically have monopolized the creation and distribution of money, have taken notice and begun developing their own virtual currencies to compete. China, for example, recently began testing the “digital yuan,” a fully electronic form of money under the control of its People’s Bank.

Part of cryptocurrencies’ astonishing acceleration in recent years stems from a changed appreciation of their value potential. Consistent with the initial conception of virtual currency as a medium of exchange, early analyses of cryptocurrencies’ price focused on their utility for daily transactions. Most recently, institutional investors have also come to appreciate cryptocurrencies as a store of value and a potential hedge against inflation. This took on heightened importance during the COVID-19 pandemic as increased government spending sparked new concerns about the erosion of value of sovereign currency. Countries like Venezuela, which has seen hyperinflation of its currency, have unsurprisingly witnessed huge increases in the acquisition and use of cryptocurrency by their citizens.

What Is Cryptocurrency?

At its core, cryptocurrency is just software. But unlike other forms of software, cryptocurrency does not enable a human user to perform another function, such as word processing or preparing spreadsheets. Rather, it exists as a medium of exchange, i.e., an item of value that can be passed from one user to another without bartering over in-kind consideration. Although cryptocurrency software necessarily enables the tracking of transactions, it goes further and actually *creates* the item of value to be exchanged, namely digital “coins” that—in the case of private cryptocurrencies like Bitcoin—are untethered to any particular value in sovereign currency or other commodity. The coins have no physical existence and can only be exchanged electronically, but unlike electronic transactions in sovereign currency, no bank or other intermediary needs to be involved, so no debits are made against one party’s checking account or credits added to another’s.

The “crypto” in cryptocurrency comes from the fact that cryptographic software takes the place of a bank to enable two parties who do not trust (or even know) each other nevertheless to have confidence in their transaction. Although no physical record of a cryptocurrency transaction exists, the virtual change-of-hands is tracked in a ledger, preventing users from spending the same coin twice. For private cryptocurrencies, the ledger is open-source and distributed across the entire network of users, and thus not subject to the control of any one person or entity. In this regard, cryptocurrency differs markedly from sovereign currency, which—as in the case of China’s digital yuan—is under the control of a central banking system.

Given that cryptocurrency exists as a purely virtual—and, indeed, invented—item of value, one might wonder why anyone would assign it any value at all. This is hardly idle speculation, as economists as prominent as Paul Krugman have voiced skepticism about cryptocurrencies' viability. But cryptocurrency proponents respond that the same critique could be offered against most sovereign currencies, which are aptly called "fiat" currency because they have no intrinsic value and are not backed by any underlying asset. In fact, proponents observe, cryptocurrency compares favorably with both paper money and historical currencies like precious metals on most of the characteristics that make a currency successful long term, such as scarcity, divisibility, and utility.

Legal Regulation and Recognition

In the United States, the anonymous nature of cryptocurrency has sparked concerns about accountability. In its January 2017 report, *Distributed Ledger Technology: Implications of Blockchain for the Securities Industry*, the Financial Industry Regulatory Authority observed that in the case of Bitcoin, "no party is responsible or accountable for the proper operation of the system," a fact that "may present risks to markets and investors." Acknowledging these risks, the chairmen of the Commodity Futures Trading Commission and the Securities and Exchange Commission jointly published a January 2018 op-ed questioning "whether our historic approach to regulation of currency transactions is appropriate for the cryptocurrency market." Since then, multiple federal and state agencies have asserted some level of authority with respect to cryptocurrency transactions of one form or another. In 2019, for example, the Treasury Department's Financial Crimes Enforcement Network, Commodity Futures Trading Commission, and Securities and Exchange Commission issued a joint statement defining cryptocurrency exchanges as "money service businesses," thus making them subject to anti-money-laundering and know-your-customer regulations under the Bank Secrecy Act.

The legislative reaction, however, has largely been concerned with enabling the continued growth and expansion of the cryptocurrency economy, modeled on the hands-off approach to internet regulation in the 1990s. At the federal level, the Token Taxonomy Act of 2019 would have excluded digital assets from the definition of "security" under the federal securities laws—as well as preempted any contrary state securities law—and exempted profits from certain cryptocurrency exchanges from treatment as income under the Internal Revenue Code. The Crypto-Currency Act of 2020, similarly, would have curtailed the present regulatory overlap by designating particular federal agencies as primarily responsible for oversight of different types of digital transactions. Although neither bill became law, one can expect similar measures to be introduced in the future to avoid the perceived risk of "flight" of digital capital to jurisdictions with less cumbersome regulations.

Part of cryptocurrencies' astonishing acceleration in recent years stems from a changed appreciation of their value potential, most recently as a store of value and a potential hedge against inflation.

States, too, have crafted legislation to recognize and protect digital assets to attract lucrative cryptocurrency business. Vermont, for example, established a new form of business entity, the "blockchain-based limited liability company," that would extend the corporate principle of limited liability to blockchain enterprises. Under its approach, a blockchain entity's rules of corporate governance may simply be built into its software code rather than written out separately as an operating agreement or corporate charter. Even

New York, which in 2015 enacted perhaps the nation's most onerous cryptocurrency regulations through its "BitLicense" requirement, has stated that it will begin allowing conditional licenses with less rigorous requirements, provided that a new licensee partners with an existing one with an established presence in the state.

But the state that has garnered by far the most attention is Wyoming. Beginning with a 2018 law exempting certain digital assets from state securities regulations, the Wyoming legislature has passed more than a dozen bills to encourage the formation of cryptocurrency and blockchain startups in the state. These bills have cut across a variety of legal fronts, recognizing virtual assets as property and exempting them from existing restrictions under corporate, tax, and bank-

ing regulations. Wyoming's most noteworthy innovation in this regard is the establishment of a separate chancery court dedicated to business disputes. Modeled after Delaware's court of chancery, Wyoming's new court is positioned to become the first in the United States to develop a body of specialized case law on blockchain and virtual currency businesses, cementing Wyoming's status as "the Delaware of cryptocurrency." ^{LN}

RESOURCES

- James Areddy, "China Creates Its Own Digital Currency, a First for Major Economy," *Wall St. J.* (Apr. 5, 2021).
- Caitlin Long, "What Do Wyoming's 13 New Blockchain Laws Mean?," *Forbes* (Mar. 4, 2019).
- Robert A. Schwinger, "Liability Rumbblings along the Blockchain," *N.Y. L.J.* (July 15, 2019).
- ② Oliver Goodenough, "Why Blockchain Governance Matters," *Vermont Emerging Tech Law Blog* (Nov. 19, 2018).
- ② Pierluiga Matera, "Delaware's Dominance, Wyoming's Dare—Blockchain Companies and the Market for Corporate Charters," *Oxford Bus. Law Blog* (Mar. 25, 2021).
- ② Financial Industry Regulatory Authority, "Distributed Ledger Technology: Implications of Blockchain for the Securities Industry," *finra.org* (Jan. 21, 2017).
- Token Taxonomy Act, H.R. 2144, 116th Cong. (2019).
- Crypto-Currency Act, H.R. 6154, 116th Cong. (2020).
- ▲ *CFTC v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018).