

## THE RIGHT SIDE OF THE COIN: STATE APPROACHES IN REGULATING VIRTUAL CURRENCIES

By: Zachary Miller

### I. INTRODUCTION

Virtual currencies—often referred to as cryptocurrencies, bitcoins, and tokens—are becoming a mainstay in America’s economy. Virtual currency began its rise on October 31, 2008, the day mystery man “Satoshi Nakamoto” published the infamous Bitcoin white paper, which described the virtual currency platform and underlying blockchain technology.<sup>1</sup> Bitcoin was given monetary value for the first time in 2010 when an individual purchased pizza in exchange for Bitcoin.<sup>2</sup> In just ten years, Bitcoin has achieved a market capitalization in excess of \$724,000,000,000 dollars.<sup>3</sup>

Since 2016, Bitcoin and other alternative coins—known as “alt coins”—have emerged from the fringes of the internet and are freely traded amongst the retail and institutional investing communities.<sup>4</sup> Bitcoin futures are also traded on prominent derivatives marketplaces such as the Chicago Mercantile Exchange (CME), and Bitcoin is even available for purchase from specialized ATMs and notable money transmitter services such as the Cash app.<sup>5</sup>

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<sup>1</sup> Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (Oct. 31, 2008), [nakamotoinstitute.org/bitcoin/](http://nakamotoinstitute.org/bitcoin/).

<sup>2</sup> Bernard Marr, *A Short History of Bitcoin and Crypto Currency Everyone Should Read*, FORBES (Dec. 6, 2017, 12:28 AM), <https://www.forbes.com/sites/bernardmarr/2017/12/06/a-short-history-of-bitcoin-and-crypto-currency-everyone-should-read/#5cb9d9b83f27>.

<sup>3</sup> *Today’s Cryptocurrency Prices by Market Capitalization*, COINMARKETCAP, <https://coinmarketcap.com/> (last visited Aug. 4, 2021).

<sup>4</sup> See Eric Rosenberg, *History of Cryptocurrency*, the balance (Mar. 30, 2021), <https://www.thebalance.com/history-of-cryptocurrency-5119511>

<sup>5</sup> *Bitcoin futures and options*, CME GROUP, <https://www.cmegroup.com/trading/bitcoin-futures.html> (last visited Mar. 20, 2021); see also Benjamin Pirus, *CME Bitcoin Futures Now Average \$370 Million In Trading Per Day*, FORBES (Aug. 28, 2019, 8:01 AM), <https://www.forbes.com/sites/benjaminpirus/2019/08/28/cme-bitcoin-futures-now-average-370-million-in-trading-per-day/#4cbdf2067ea> (Bitcoin Futures); Rick D., *Continued Spread of Bitcoin ATMs Normalizing Cryptocurrency Around the World*,

Virtual currencies are growing more popular in consumer and peer-to-peer business transactions. Overstock.com, PayPal, and Microsoft all began to accept Bitcoin as a form of payment in 2014.<sup>6</sup> Even the Dallas Mavericks, a professional basketball team owned by billionaire Mark Cuban, accept Bitcoin as a method of payment for tickets and merchandise.<sup>7</sup>

Blockchain, the peer-to-peer distributed network technology underlying all Bitcoin transactions, has also amplified the popularity of virtual currencies due to its utility for business and administrative functions.<sup>8</sup> For example, many of the largest corporations in the world are either developing or acquiring blockchain based technologies.<sup>9</sup> Additionally, several state and local governments have acknowledged blockchain's utility in record keeping and other ministerial functions; these localities are taking action to formalize, implement, or otherwise research blockchain technology.<sup>10</sup> Notwithstanding, only a few states have taken legislative initiative by enacting legislation or promulgating

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BEINCRYPTO (Jan. 2, 2020), <https://beincrypto.com/continued-spread-of-bitcoin-atms-normalizing-cryptocurrency-around-the-world/> (Bitcoin ATMs); Cash App, *My First Bitcoin and the Legend of Satoshi Nakamoto*, <https://cash.app/bitcoin> (last visited Mar. 20, 2021) (The Cash App).

<sup>6</sup> Cade Metz, *Overstock.com Becomes First Major Retailer to Accept Bitcoin Worldwide*, WIRE (Sept. 11, 2014, 9:20 AM), <https://www.wired.com/2014/09/overstock-com-becomes-first-major-retailer-accept-bitcoin-worldwide/>; PAYPAL PUBLIC POLICY, *Blockchain*, <https://publicpolicy.paypal-corp.com/issues/blockchain> (last visited Mar. 20, 2021); CNNMoney, *Microsoft begins accepting Bitcoin*, Harford Business Journal (Dec. 11, 2014), <https://www.hartfordbusiness.com/article/microsoft-begins-accepting-bitcoin#:~:text=Microsoft%20is%20now%20accepting%20the,Microsoft's%20payment%20and%20billing%20policy.>

<sup>7</sup> Paige Vasquez, *Dallas Mavericks Offer Special Merchandise Discounts for Bitcoin Buyers*, NBA (Dec. 22, 2020), [mavs.com/bitcoin-buyers/](https://mavs.com/bitcoin-buyers/).

<sup>8</sup> According to IBM “[b]lockchain is a shared, immutable ledger that facilitates the process of recording transactions and tracking assets in a business network.”<sup>8</sup> IBM, *What is blockchain technology?*, <https://www.ibm.com/blockchain/what-is-blockchain> (last visited Mar. 20, 2021).

<sup>9</sup> Michael del Castillo, *Big Blockchain: The 50 Largest Public Companies Exploring Blockchain*, FORBES (July 3, 2018, 8:46 AM), <https://www.forbes.com/sites/michaeldelcastillo/2018/07/03/big-blockchain-the-50-largest-public-companies-exploring-blockchain/#60cfc6752b5b> (“[N]ot only are all ten of the largest public companies in the world exploring blockchain, but at least 50 of the biggest names on the [Forbes Global 2000] list have all made their own mark on technology first inspired by bitcoin.”).

<sup>10</sup> Heather Morton, *Blockchain State Legislation*, NATIONAL CONFERENCE OF STATE LEGISLATURES (Mar. 28, 2019), <http://www.ncsl.org/research/financial-services-and-commerce/the-fundamentals-of-risk-management-and-insurance-viewed-through-the-lens-of-emerging-technology-webinar.aspx>.

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regulations specifically addressing virtual currencies, while others have chosen to address blockchain technology alone.<sup>11</sup>

This comment will first discuss how the ambiguous and amorphous nature of virtual currency leads to problems in defining, and in turn, effectively regulating virtual currency. Part II will explore the federal government's approach to regulating the crypto space. This approach is largely driven by an interest in combating money laundering, financing of illicit criminal activity (mainly narcotics trafficking and terrorism financing),<sup>12</sup> and the enforcement of federal securities law.<sup>13</sup> Ultimately, federal virtual currency regulation is steeped in an enforcement paradigm.<sup>14</sup> In light of the federal approach, Part III will analyze the regulatory approaches at the state level, which is largely driven by competing consumer protection and economic assimilation and advancement goals. Specifically, Part III provides a deeper analysis of the regulatory schemes enacted in Wyoming, Colorado, Connecticut, Hawaii and Washington State. Part IV will seek to advocate for the "crypto-friendly" approaches adopted by Wyoming and Colorado, while highlighting the shortcomings and pitfalls of the more burdensome money transmitter and surety bond requirements applied to virtual currency businesses in Hawaii, Connecticut, and Washington.

## PART II: SQUARE PEG, ROUND HOLE: DEFINING VIRTUAL CURRENCIES AS SECURITIES & FEDERAL MONEY TRANSMITTER REQUIREMENTS

### A. SECURITIES LITIGATION & VIRTUAL CURRENCY

The Securities and Exchange Commission's Strategic Hub for Innovation and Financial Technology ("FinHub") recently published an analytical framework for entities considering an Initial Coin Offering ("ICO") to determine whether the given virtual currency or ICO falls within the definition of a "security."<sup>15</sup> While this guidance is useful, it does not supersede existing regulations or federal precedent

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<sup>11</sup> *Id.*

<sup>12</sup> See generally Financial Crimes Enforcement Network, 31 U.S.C. § 310 (2010); Treas. Order 180-01 (Jul. 1, 2014), <https://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/to180-01.aspx>.

<sup>13</sup> See generally SECURITIES ACT OF 1933, 15 U.S.C. § 77a et seq. (1933); Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. (1934).

<sup>14</sup> See *infra* PART II.

<sup>15</sup> U.S. SECURITIES & EXCHANGE COMM.: FRAMEWORK FOR "INVESTMENT CONTRACT" ANALYSIS OF DIGITAL ASSETS (April 3, 2019), [https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#\\_edn1](https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_edn1).

surrounding issues of securities registration requirements for virtual currencies.<sup>16</sup>

The Securities Act of 1933 (“the ‘33 Act”) and Securities Exchange Act of 1934 (“the Exchange Act”) collectively created The Securities and Exchange Commission (“SEC”).<sup>17</sup> Congress created the SEC and its robust regulatory scheme to prevent financial institutions and publicly traded companies from disseminating the kind of fraudulent and misleading information that brought about the stock market crash in 1929.<sup>18</sup> The ‘33 Act and the Exchange Act achieve their goals by promulgating securities registration and reporting requirements for issuing companies. Of central importance is the ‘33 Act’s definitional criteria for what kinds of agreements, offerings, and business arrangements would be considered an “investment contract,” and in turn, a security.<sup>19</sup>

One of the seminal cases in securities litigation, *SEC v. Howey Co.*,<sup>20</sup> enumerated a test to determine whether a given asset qualifies as an investment contract subject to securities registration requirements: “a contract, transaction or scheme whereby a person [1] invests his money [2] in a common enterprise and [3] is led to expect profits solely [sic] from the efforts of the promoter or a third party.”<sup>21</sup> The *Howey* court emphasized that the investment contract analysis embodies a flexible interpretational approach “that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”<sup>22</sup> *Howey’s* flexible economic reality approach allows the test to serve as a vital tool in rooting out dubious, and often stranger than fiction, offerings and schemes.<sup>23</sup>

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<sup>16</sup> *Id.* at n.1 (“This framework represents the views of the Strategic Hub for Innovation and Financial Technology . . . this framework does not replace or supersede existing case law, legal requirements, or statements or guidance from the Commission or Staff.”) [hereinafter FRAMEWORK FOR “INVESTMENT CONTRACT”].

<sup>17</sup> SECURITIES ACT OF 1933, 15 U.S.C. § 77a et seq.; SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. § 78a et seq.; *What We Do*, U.S. SECURITIES & EXCHANGE COMM., <https://www.sec.gov/Article/whatwedo.html> (last visited Mar. 20, 2021).

<sup>18</sup> See History.com Editors, *SEC: Securities and Exchange Commission*, HISTORY (Dec. 6, 2019), <https://www.history.com/topics/us-government/securities-and-exchange-commission>.

<sup>19</sup> 15 U.S.C. § 77b(a)(1) (2012). Among a host of categories, the term “security” is defined as “any note, stock, bond, [or] investment contract . . .”

<sup>20</sup> *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946).

<sup>21</sup> *Id.* at 298-99.

<sup>22</sup> *Id.* at 299.

<sup>23</sup> See, e.g., *Miller v. Cent. Chinchilla Grp., Inc.*, 494 F.2d 414 (8th Cir. 1974) (involving a scheme in which promoters agreed to purchase chinchilla offspring from investors at above market prices and return profits after successful marketing in exchange for

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The history of financial fraud is as old as currency itself and, as such, it is of little surprise that entrepreneurs and hackers alike have seized the opportunity to capitalize on the public's interest in virtual currency by crafting fraudulent initial coin offerings, or alternatively, by stealing investor's funds through technological means.<sup>24</sup> In light of the rampant fraud in the virtual currency space, the federal government cracked down on unregistered ICOs and related secondary offerings by urging courts to apply *Howey* to all such offerings.<sup>25</sup> It is important to note the gravity of labeling a virtual currency offering as an investment contract because such a finding triggers a myriad of federal and state regulations in which compliance is, in many cases, prohibitively expensive and arduous.<sup>26</sup> For example, among a litany of required financial disclosures, SEC Regulation S-X mandates the inclusion of audited balance sheets going back two years, as well as audited income statements for the previous three years.<sup>27</sup>

The Court in *United States v. Zaslavskiy* faced the threshold question of whether virtual currency tokens are securities as defined by the Securities Act.<sup>28</sup> Ultimately, the court applied the *Howey* test in concluding that the virtual currency "tokens" and corresponding ICOs at

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investors' commitment to raise chinchillas); *see also*, *Smith v. Gross*, 604 F.2d 639 (9th Cir. 1979) (involving an earthworm breeding investment scheme).

<sup>24</sup> *See* Ana Alexandre, *New Study Says 80 Percent of ICOs Conducted in 2017 Were Scams*, COIN TELEGRAPH (Jul. 13, 2018), <https://cointelegraph.com/news/new-study-says-80-percent-of-icos-conducted-in-2017-were-scams>; *see also* Brian Barrett, *Hack Brief: Hackers Stole \$40 Million from Binance Cryptocurrency Exchange*, WIRED (May 8, 2019, 1:20 PM), <https://www.wired.com/story/hack-binance-cryptocurrency-exchange/>.

<sup>25</sup> Because the SEC considers ICOs as securities, the majority of cases brought against issuers center around violations of § 77f. *See* U.S. SECURITIES & EXCHANGE COMM.: FRAMEWORK FOR "INVESTMENT CONTRACT" ANALYSIS OF DIGITAL ASSETS (April 3, 2019), [https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#\\_edn1](https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_edn1); 15 U.S.C. § 77f requires the registration of publicly offered securities through the filing of a signed registration statement[.]

<sup>26</sup> *See* U.S. SECURITIES AND EXCHANGE COMMISSION, *What is a Registration Statement?* (Nov. 29, 2017), <https://www.sec.gov/smallbusiness/goingpublic/registrationstatement>; *see also* U.S. SECURITIES AND EXCHANGE COMMISSION, *Filing Review Process* (Sept. 27, 2019), <https://www.sec.gov/divisions/corpfin/cffilingreview.htm>.

<sup>27</sup> *See generally* 17 C.F.R. §§ 210.1–210.12. Note that disclosures differ for "emerging growth companies" which a majority of virtual currency entities would qualify as. While this comment will not explore the details of the securities registration process, such information is included for the sole purpose of emphasizing the cost and difficulty of registration.

<sup>28</sup> *United States v. Zaslavskiy*, No. 17-CR647(RJD), 2018 U.S. Dist. LEXIS 156574, at \*13 (E.D.N.Y. Sept. 11, 2018).

issue could satisfy the definition of securities.<sup>29</sup> At issue in *Zaslavskiy* was whether the defendant “made materially false and fraudulent representations and omissions” when courting investors for two virtual currency entities: REcoin Group Foundation, LLC (“Recoin”) and DRC World, Inc. (“Diamond”).<sup>30</sup> REcoin was geared towards creating smart contracts purportedly “backed by domestic and international real estate investments[.]”<sup>31</sup> Diamond sought to create a virtual currency backed by “real world assets” specifically, diamonds.<sup>32</sup> Both vehicles promised substantial returns on investment in exchange for participation in either, or both, ICOs.<sup>33</sup> The Defendant’s failure to dismiss the charges against him by advancing a vagueness as applied challenge illustrates the fact-intensive inquiry necessitated by *Howey*, especially when applied to asset classes that have been in existence for less than twenty years.<sup>34</sup>

This contention is further supported by another recent case concerning alleged violations of federal securities law by the founder of a virtual currency exchange. The Court in *SEC v. Blockvest, LLC*<sup>35</sup> denied the SEC’s motion for preliminary injunction because in the initial stages of litigation, it was not clear whether the virtual coins at issue satisfied the test under *Howey*.<sup>36</sup> Here, the Defendant attempted to create a virtual currency exchange for the sale of a particular digital asset referred to as “BLVs” through a multi-stage sale culminating with a 100 million dollar ICO launch.<sup>37</sup> The decision turned on whether the future interest in the virtual currency exchange held by thirty-two-test investors constituted a reasonable expectation of profits, as required under the second-prong of *Howey*.<sup>38</sup> As further evidenced in *Blockvest*,

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<sup>29</sup> *Id.* at \*23 (denying Defendant’s motion to dismiss on the grounds that, “a reasonable jur[or] [could] find that the investment opportunities described satisfy the *Howey*, [*sic*] test, and therefore meet the definition of ‘security’”).

<sup>30</sup> *Id.* at \*1.

<sup>31</sup> *Id.* at \*3-4.

<sup>32</sup> *Id.* at \*5.

<sup>33</sup> *Id.* at \*3-6. According to the REcoin white paper, investors could “convert their savings into real estate-backed currency for the potential of high returns to protect their earnings from inflation[.]” The Defendant also projected “a minimum growth of 10%-15% per year” on Diamond investments.

<sup>34</sup> See *Zaslavskiy*, 2018 U.S. Dist. LEXIS 156574 at \*2.

<sup>35</sup> *SEC v. Blockvest, LLC*, No.18-CV-2287-GPB (BLM) 2018 U.S. Dist. LEXIS 200773, at \*2 (S.D. Cal. Nov. 27, 2018).

<sup>36</sup> *Id.* at \*20-21 (finding that disputed issues of fact could not lead the Court to “make a determination whether the test BLV tokens were ‘securities’ under the first prong of *Howey*[.]” and that the SEC did not show that, “the 32 test investors had an ‘expectation of profits.’”)

<sup>37</sup> *Id.* at \*4.

<sup>38</sup> *Id.* at \*20.

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minor factual details can make *Howey* analysis convoluted, for example whether an offering to test-investors constitutes a public offering or whether those investors had a reasonable expectation of profit. These details all but guarantee an inquiry deeper than what is required at the initial pleading stages of litigation, and likely at the summary judgment stage as well.

Ultimately, these cases demonstrate how securities litigation, as applied to virtual currencies and ICOs, are likely to produce voluminous litigation in the foreseeable future based on the adopted broad readings of federal securities laws, coupled with the fact-intensive inquiry necessitated by *Howey*. The Federal Government's efforts in defining virtual currencies has also been frustrated by the divergent approaches of the different regulatory agencies, due in large part to each agency's concerns in their respective areas of responsibility.<sup>39</sup> Notwithstanding, efforts to coherently define virtual currencies in one box is akin to the adage of putting a square peg in a round hole—one may eventually hammer the peg through the hole, but there will always be pushback and difficulty in doing so.

#### B. FINANCIAL CRIMES ENFORCEMENT NETWORK (FINCEN) MSB REQUIREMENTS

In 1990, Congress passed 31 U.S.C. § 310, in turn creating a new bureau within the United States Treasury: the Financial Crimes Enforcement Network ("FinCEN").<sup>40</sup> This specialized bureau was tasked with protecting the American financial infrastructure by assisting federal, state, and international law enforcement by enforcing important anti-money laundering provisions under the Bank Secrecy Act (BSA).<sup>41</sup> FinCEN's prominence increased after 9/11 revealing the prevalence of the illicit financing of terrorism activities. Consequently, the PATRIOT Act empowered FinCEN to pivot into a greater enforcement role, rather than an informational and analytical resource

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<sup>39</sup> Compare U.S. TREAS., FIN. CRIMES ENF'T. NETWORK, FIN-2019-G001, APPLICATION OF FINCEN'S REGULATIONS TO CERTAIN BUSINESS MODELS INVOLVING CONVERTIBLE VIRTUAL CURRENCIES 22 (May 9, 2019), <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf> (discussing application of Bank Secrecy Act regulations to virtual currency business models); and FRAMEWORK FOR "INVESTMENT CONTRACT", *supra* note 15 (discussing potential application of federal securities law registration requirements for companies considering Initial Coin Offerings (ICOs)).

<sup>40</sup> Financial Crimes Enforcement Network, 31 U.S.C. § 310 (2010); *see also* Treas. Order 180-01 (Jul. 1, 2014).

<sup>41</sup> 31 U.S.C. §§ 5311-5332 (2001); *see also* FIN. CRIMES ENF'R. NET., *Law Enforcement Overview* <https://www.fincen.gov/resources/law-enforcement-overview> (last visited March 12, 2021).

for other law enforcement entities.<sup>42</sup> FinCEN is responsible for ensuring Money Service Businesses (MSBs) comply with registration and reporting requirements under the BSA.<sup>43</sup> The Treasury Secretary has the power to order registered money transmitters to furnish their books and records, as well as the power to promulgate anti-money laundering compliance mechanisms; these powers provide an important incentive for MSBs to comply with FinCEN's mandates in this area.<sup>44</sup>

Since 2011, FinCEN has taken a leading role in asserting itself into the cryptocurrency space by promulgating regulations under the BSA to further clarify the kinds of virtual currency entities falling underneath the Money Services Business criteria.<sup>45</sup> Even without explicitly mentioning virtual currencies by name, the catch-all language effectively stretched the definition of MSBs to include virtual currency businesses by stating, "'money transmission services' means the acceptance of currency, funds, or other value that substitutes for currency[.]"<sup>46</sup> The "or other value" language bears significance because the federal government's position on what is considered virtual currency depends largely on which regulatory agency is being asked to define it.<sup>47</sup> Because broad catch-all definitions seldom provide clarity, FinCEN has opted to continually provide guidance on how existing regulations apply to virtual currency business models.<sup>48</sup>

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<sup>42</sup> See generally, §§ 5311-5332; USA PATRIOT Act of 2001, Pub. L. 107-56, §§ 311-362 (Oct. 26, 2001).

<sup>43</sup> 31 U.S.C. § 5330(d)(1)(A) (2001) ("The term 'money transmitting business' means any business . . . which [] provides check cashing, currency exchange, or money transmitting or remittance services, or issues or redeems money orders, travelers' checks, and other similar instruments, . . . transmission of funds, including any person who engages as a business in an informal money transfer system.").

<sup>44</sup> See 31 U.S.C. § 5318 (2014).

<sup>45</sup> See Bank Secrecy Act Regulations; Definitions and Other Regulations Relating to Money Service Businesses, 31 C.F.R. §§ 1010, 1021, 1022 (2014).

<sup>46</sup> See 31 C.F.R. § 1010.100(ff)(5)(i)(A) (emphasis added).

<sup>47</sup> See, e.g., INTERNAL REV. SER., *IRS Virtual Currency Guidance: Virtual Currency is Treated as Property for U.S. Federal Tax Purposes; General Rules for Property Transactions Apply*, (Mar. 25, 2014), <https://www.irs.gov/newsroom/irs-virtual-currency-guidance>; but see, e.g., *Commodity Futures Trading Commission v. McDonnell*, 287 F.Supp.3d 213, 228 (E.D.N.Y. 2018) (holding that "[v]irtual currencies can be regulated by CFTC as a commodity [because] [v]irtual currencies are 'goods' exchanged in a market for a uniform quality or value."); and see SECURITIES AND EXCHANGE COMM'N., *Statement on Potentially Unlawful Online Platforms for Trading Digital Assets* (Mar. 7, 2018), <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading> ("A number of [virtual currency] platforms provide a mechanism for trading assets that meet the definition of a 'security' under federal securities laws.").

<sup>48</sup> See generally U.S. TREAS., *supra* note 39.

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Generally, the federal approach to virtual currency regulation is primarily motivated by anti-money laundering, anti-fraud, and general compliance with a given agency's regulatory scheme. As the federal government controls the dollar, it has little incentive to regulate virtual currencies in a manner that would foster growth and allow for greater assimilation into the economy. Doing so could threaten the dollar's hegemony. The same set of motivations, however, cannot be attributed to the states.

### PART III: STATE REGULATORY EFFORTS

#### A. OVERVIEW OF THE STATE REGULATORY LANDSCAPE

The federal government and the states have distinct interests in regulating virtual currencies. While the federal government's focus is centered on enforcing existing securities laws<sup>49</sup> and anti-money laundering laws,<sup>50</sup> the states are more interested in consumer protection.<sup>51</sup> For example, "Operation Cryptosweep" is a task force consisting of state-level law enforcement and securities regulators that are members of the North American Securities Administrators Association (NASAA).<sup>52</sup> Operation Cryptosweep "has resulted in more than 330 inquiries and investigations and at least 85 enforcement actions related to ICOs or cryptocurrency investment products."<sup>53</sup> As virtual currencies have increased in popularity, so have state governments' interest in facilitating the implementation of these technologies into their business communities, counties, and municipalities. Wyoming is regarded as the chief innovator in virtual currency legislation.<sup>54</sup> Recently, states such as Colorado have entered the fray by passing legislation like the Digital Token Act in early 2019.<sup>55</sup>

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<sup>49</sup> See SECURITIES ACT OF 1933, 15 U.S.C. § 77a et seq.; Securities Exchange Act of 1934, 15 U.S.C. § 78a.

<sup>50</sup> FINANCIAL CRIMES ENFORCEMENT NETWORK, 31 U.S.C. § 310 (2010); see also Treas. Order 180-01 (Oct. 21, 2002).

<sup>51</sup> NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOC., *State and Provincial Securities Regulators Conduct Coordinated International Crypto Crackdown*, (May 21, 2018), <https://www.nasaa.org/45121/state-and-provincial-securities-regulators-conduct-coordinated-international-crypto-crackdown-2/> ("A critical component of 'Operation Cryptosweep' is raising public awareness of the risks associated with ICOs and cryptocurrency-related investment products.").

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> See Gregory Barber, *The Newest Haven for Cryptocurrency Companies? Wyoming*, WIRED (June 13, 2019, 7:00 AM), <https://www.wired.com/story/newest-haven-cryptocurrency-companies-wyoming/>.

<sup>55</sup> See COLO. REV. STAT. ANN. § 11-51-308.7 (West 2019).

Notwithstanding these innovative states, the number of jurisdictions passing legislation specifically addressing virtual currency is scant. Instead, most states have opted to either exempt such businesses from securities registration requirements,<sup>56</sup> revise their Money Transmitter Laws (MTLs) to include virtual currency (VC) entities (similar to FinCEN's approach),<sup>57</sup> provide guidance from local regulatory agencies,<sup>58</sup> or refrain from action altogether.<sup>59</sup> A recent trend *has* developed where an increasing number of state regulators and legislatures opt to impose Money Transmitter registration requirements on VC entities.<sup>60</sup> It is important to discuss the consequences of this trend as state MTLs can be particularly burdensome for VC entities.

#### B. THE BURDENS OF STATE MONEY TRANSMITTER REQUIREMENTS

A few states have chosen to exempt Virtual Currency Exchangers from Money Transmitter licensing requirements by adopting a definition of "money" that does not include virtual currencies.<sup>61</sup> It logically follows that a virtual currency transmitter would not qualify as a "money" transmitter in the strict sense of the word. For example, as early as 2014, the Kansas Banking Commission declared that existing Money Transmitter Laws need not be amended to include virtual

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<sup>56</sup> See, e.g., *Id.* (providing a number of exemptions from securities regulation requirements), and WYO. STAT. ANN. § 34-29-102 (2019) (divided assets into three categories of intangible personal property, two of which are exempt from securities registration requirements).

<sup>57</sup> See, GA. CODE ANN. § 7-1-690 (2016); ALA. CODE § 8-7A-2 (LexisNexis 2017).

<sup>58</sup> See, e.g., KAN. OFFICE OF THE STATE BANK COMM'N, Guidance Document MT 2014-01, *Regulatory Treatment of Virtual Currencies Under the Kansas Money Transmitter Act*, (June 6, 2014), [https://www.osbckansas.org/wp-content/uploads/mt2014\\_01\\_virtual\\_currency.pdf](https://www.osbckansas.org/wp-content/uploads/mt2014_01_virtual_currency.pdf); ILL. DEP'T OF FIN. AND PROF. REG., *Digital Currency Regulatory Guidance* (June 13, 2017), <https://www.idfpr.com/Forms/DFI/CCD/IDFPR%20-%20Digital%20Currency%20Regulatory%20Guidance.pdf>.

<sup>59</sup> See Matthew E. Kohen & Justin S. Wales, *State Regulations on Virtual Currency and Blockchain Technologies*, CARLTON FIELDS (Oct. 17, 2017), <https://www.carltonfields.com/insights/publications/2018/state-regulations-on-virtual-currency-and-blockchain-technologies> (last updated August 29, 2019). Examples of state's remaining relatively inactive include Alaska, Mississippi, and South Dakota.

<sup>60</sup> See *infra* Part II, Sec. B.

<sup>61</sup> See KAN. OFFICE OF THE STATE BANK COMM'N, *supra* note 58.

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currencies because virtual currencies cannot be defined as money.<sup>62</sup> Illinois' financial regulatory arm followed suit later in 2017.<sup>63</sup>

In 2019, the Texas Department of Banking issued regulatory guidance.<sup>64</sup> That guidance stated that virtual currencies do not fall within the state's definition of currency because, "neither centralized virtual currencies nor cryptocurrencies are coin and paper money issued by the government of a country[.]"<sup>65</sup> The exception to the rule are exchanges of pegged virtual currencies, commonly referred to as "stablecoins."<sup>66</sup> These kinds of virtual currencies are either pegged to the value of sovereign currency, or other commodities holding recognized intrinsic value such as stocks and bonds.<sup>67</sup> Stablecoins, while not as well known or popular as other virtual currencies, may nonetheless provide an interesting foray for states in the coming years, especially those that have legalized the sale of recreational cannabis. Similar to cryptocurrencies, proceeds from the legal cannabis industry have been shunned from the federal banking system.<sup>68</sup> Consequently, these businesses deal largely in cash transactions, which is inherently difficult to track and tax.<sup>69</sup> States have an incentive to efficiently monitor and tax the recreational and medicinal cannabis industry, being that it is a billion-dollar industry with an equally robust illicit market.

Acknowledging this problem, the California state assembly introduced legislation in 2019 that would allow licensed Cannabis entities to remit, "any city or county cannabis license tax amounts due by payment using stablecoins[.]"<sup>70</sup> Unfortunately, the California

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<sup>62</sup> See KAN. OFFICE OF THE STATE BANK COMM'N, *supra* note 58.

<sup>63</sup> See ILL. DEP'T OF FIN. AND PROF'L. REGUL., *Digital Currency Regulatory Guidance* (June 13, 2017), <https://www.idfpr.com/Forms/DFI/CCD/IDFPR%20-%20Digital%20Currency%20Regulatory%20Guidance.pdf>

<sup>64</sup> TEX. DEP'T OF BANKING, Supervisory Memorandum – 1037, *Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act* (Apr. 1, 2019), <https://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf>.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> See generally, CB INSIGHTS, *What are Stablecoins?* (Feb. 16, 2021), <https://www.cbinsights.com/research/report/what-are-stablecoins/> (Research report discussing stablecoins, virtual currencies which are pegged to the value of gold, the US dollar, or other stable commodities or currencies. Many crypto investors hedge their positions in more volatile virtual currencies with investments in stablecoins).

<sup>68</sup> James J. Black & Marc-Alain Galeazzi, *Cannabis Banking: Proceed with Caution*, AM. BAR ASSOC. (Feb. 06, 2020), [https://www.americanbar.org/groups/business\\_law/publications/blt/2020/02/cannabis-banking/](https://www.americanbar.org/groups/business_law/publications/blt/2020/02/cannabis-banking/).

<sup>69</sup> *Id.*

<sup>70</sup> An act to add Section 34015.5 to the Revenue and Taxation Code, relating to taxation. A.B. 3090, 2019-20 Reg. Sess. (Cal. 2020) (introduced).

legislature fell short in advancing the stablecoin cannabis tax remittance bill. Nonetheless, such a bill demonstrates the unique crossroads of the cannabis and virtual currency industries, and importantly, the efficiencies such laws can create for local governments. For example, a law similar to what was proposed in California would allow for greater efficiency in tax collection for two reasons: (1) The bill pegs stablecoins to the U.S. Dollar, making them easily convertible, and (2) transactions on an immutable ledger are inherently easier to track, and in turn, tax than traditional cash transactions.<sup>71</sup> Thus, if such a bill were enacted in a recreational cannabis state, it would increase tax revenue collection with the added benefit of ensuring that licensed cannabis dealers and cultivators are not diverting their funds and product into illicit channels.<sup>72</sup> Notwithstanding their potential utility burgeoning popularity, stablecoins have yet to be embraced to attain the notoriety of other virtual currencies.<sup>73</sup>

It is of great importance to highlight the differences between state Money Transmitter Laws, and the federal requirements under the Bank Secrecy Act (BSA) as the registration/licensing requirements for the former are far more arduous than the latter.<sup>74</sup> States require Money Transmitters to apply for a license, a process which usually entails the furnishing of detailed records including audited financial statements, personal financial and background records of all control persons.<sup>75</sup> The licensing process under State MTLs are particularly burdensome for applicants. Such applications require: (i) fees that may be prohibitively expensive for entrepreneurs and small businesses; (ii) meticulous financial record keeping standards; and (iii) the submission of background checks of not only principal owners, but any key figures employed by the applicant.<sup>76</sup> Some states have a minimum net worth

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<sup>71</sup> See generally DELOITTE, *Blockchain technology and its potential in taxes*, p. 11-17 (Dec. 2017) [https://www2.deloitte.com/content/dam/Deloitte/pl/Documents/Reports/pl\\_Blockchain-technology-and-its-potential-in-taxes-2017-EN.PDF](https://www2.deloitte.com/content/dam/Deloitte/pl/Documents/Reports/pl_Blockchain-technology-and-its-potential-in-taxes-2017-EN.PDF)

<sup>72</sup> See Marie Huillet, *US Politician Uses Crypto to Buy Cannabis for Tax Remittance Demo*, COIN TELEGRAPH (Sept. 12, 2019), <https://cointelegraph.com/news/us-politician-uses-crypto-to-buy-cannabis-for-tax-remittance-demo>

<sup>73</sup> CB INSIGHTS, *Why Stablecoins Are On the Rise*, (Jan. 13, 2021), <https://www.cbinsights.com/research/stablecoins-institutional-media-interest/>.

<sup>74</sup> Marco Santori, *What is Money Transmission and Why Does it Matter?*, COIN CENTER (Apr. 7, 2015), <https://coincenter.org/entry/what-is-money-transmission-and-why-does-it-matter>. The author notes that federal money transmitter regulations serve the purpose of enforcing BSA's money laundering provisions and only require "mere registration," while state money transmitter laws usually consist of a more comprehensive licensing scheme.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

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threshold, while others require an applicant to post a surety bond.<sup>77</sup> Comparatively, under the Bank Secrecy Act, the registration process is far more constrained and only requires applicants to file a “FinCEN Form 107,” and the filing of a “list of agents” if the MSB enlists agents in their regular course of business.<sup>78</sup> Additionally, prospective MSBs must submit supporting documentation such as, “an estimate of business volume, [and] information regarding ownership or control[.]”<sup>79</sup>

Perhaps the biggest barrier to entry imposed by State MTLs, and certainly the most consequential for the virtual currency industry, are the permissible investment requirements adopted by a majority of states.<sup>80</sup> The purpose of these requirements is to protect creditors, investors, and consumers by requiring MSBs to hold in trust permissible investments, which, according to the Money Transmitter Regulators Association (MTRA), “are low risk, liquid assets such as cash and high rated investments required to be maintained in case an institution is unable to meet its commitment or fails.”<sup>81</sup> Essentially, under a permissible investment regime, MSBs may only provide a service within their means, especially when considering that most permissible investment states require money transmitters to hold permissible investments equal to their outstanding transmissions.<sup>82</sup> If an MSB’s liquid reserves do not equal its outstanding liabilities, then that MSB would be in violation of that state’s Money Transmitters Laws.<sup>83</sup>

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<sup>77</sup> Compare TEX. FIN. CODE ANN. §151.307(a) (West 2017) (minimum net worth of \$500,000 is required if a business operates through five or more locations. It has been the Department’s policy that license holders operating through the Internet are considered to be in more than five locations); with WASH. REV. CODE ANN. § 19.230.200(1)(b) (2017) (“A licensee transmitting virtual currencies must hold like-kind virtual currencies of the same volume as that held by the licensee but which is obligated to consumers . . .”).

<sup>78</sup> U.S. TREAS., FIN. CRIMES ENF’T NETWORK, *Money Services Business Registration Fact Sheet*, <https://www.fincen.gov/sites/default/files/shared/FinCENfactsheet.pdf> (last visited Mar. 20, 2021).

<sup>79</sup> *Id.*

<sup>80</sup> See generally Thomas Brown, *50-State Survey: Money Transmitter Licensing Requirements*, PAUL HASTINGS LLP [https://abnk.assembly.ca.gov/sites/abnk.assembly.ca.gov/files/50%20State%20Survey%20-%20MTL%20Licensing%20Requirements\(72986803\\_4\).pdf](https://abnk.assembly.ca.gov/sites/abnk.assembly.ca.gov/files/50%20State%20Survey%20-%20MTL%20Licensing%20Requirements(72986803_4).pdf) (last visited Mar. 20, 2021) (Thirty-three United States jurisdictions, to include Puerto Rico and the Virgin Islands, require the maintenance of permissible investments).

<sup>81</sup> CONF. OF ST. BANK SUPERVISORS & MONEY TRANSMITTERS REGULATORS ASS’N, THE STATE OF STATE MONEY SERVICES BUSINESSES REGULATION & SUPERVISION at 8 n.8 (May 2016), <https://www.csbs.org/sites/default/files/2017-11/State%20of%20State%20MSB%20Regulation%20and%20Supervision%202.pdf>.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

The imposition of Permissible Investment requirements upon virtual currency exchanges negatively impacts individual businesses and virtual currency industry as a whole. These effects have played out in recent years: for example in Hawaii, the Division of Financial Institutions (“DFI”) declared that “companies . . . offering to transmit bitcoins . . . are doing so in violation of Hawaii’s money transmitter laws.”<sup>84</sup> As a result of this announcement, virtual currency businesses operating or intending to operate in Hawaii are now required to submit to the state’s money transmitter laws, and upon licensing approval, are required to “possess permissible investments having an aggregate market value . . . of not less than the aggregate amount of all outstanding payment obligations.”<sup>85</sup>

DFI’s announcement immediately sent ripples through the virtual currency industry.<sup>86</sup> Coinbase, one of the world’s largest and most prominent virtual currency purchasing and storage platforms, announced that the consequences of DFI’s guidance were so untenable that the company had no choice but to suspend operations in Hawaii.<sup>87</sup> As a result, Hawaiian customers were left with scant alternatives because, in the words of Coinbase’s Vice President and Deputy General Counsel Juan Suarez, “we cannot recommend any service which meets Coinbase’s security standards and which is licensed to operate in Hawaii.”<sup>88</sup> Soon after Coinbase’s dramatic response, Hawaiian lawmakers introduced legislation exempting virtual currency transmitters from the permissible investments and statutory trust requirements, however, the legislation failed to make it to the governor’s desk.<sup>89</sup>

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<sup>84</sup> HAWAII DP’T OF COMM. AND CONSUMER AFF., DIV. OF FIN. INST., *News Release: State Warns Consumers on Potential Bitcoin Issues* (Feb. 26, 2014), <http://cca.hawaii.gov/dfi/news-releases/news-release-state-warns-consumers-on-potential-bitcoin-issues/>.

<sup>85</sup> HAW. REV. STAT. ANN. § 489D-8(a) (LexisNexis 2017).

<sup>86</sup> See Juan Suarez, *How Bad Policy Harms Coinbase Customers in Hawaii*, COINBASE BLOG (Feb. 27, 2017), <https://blog.coinbase.com/how-bad-policy-harms-coinbase-customers-in-hawaii-ac9970d49b34>; see also COINBASE, *Coinbase accounts – Hawaii*, <https://help.coinbase.com/en/coinbase/managing-my-account/other/coinbase-accounts-hawaii.html>.

<sup>87</sup> See Suarez, *supra* note 86; COINBASE, *supra* note 86.

<sup>88</sup> COINBASE, *supra* note 86. At the time, Coinbase was licensed in thirty-eight United States jurisdictions, to include a pending application in Hawaii. Suarez, *supra* note 86.

<sup>89</sup> S.B. 1364, 30th Leg., Reg. Sess. (Haw. 2019). The indirect ban on remained in effect until August of 2020 when Hawaii launched two-year cryptocurrency trading pilot. Andrew Gomes, *Hawaii Allows Cryptocurrency Trading Pilot After Moratorium*, GOV’T TECH. (Aug. 31, 2020), <https://www.govtech.com/budget-finance/hawaii-allows-cryptocurrency-trading-pilot-after-moratorium.html>.

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Hawaii sought to alter its money transmitter laws to enable the burgeoning virtual currency industry to function within its border.<sup>90</sup> Unfortunately, the same cannot be said of states like Connecticut. In 2017, Connecticut's legislature proposed amendments to its Money Transmitter Laws seeking to define virtual currency, and subject businesses dealing in such mediums of exchange to the state's money transmitter requirements.<sup>91</sup> These amendments were eventually codified into law in 2019.<sup>92</sup> Connecticut's money transmitter amendments go a step further than other states applying such requirements to virtual currency entities. Rather than furnishing regulatory guidance applying existing laws to these entities, Connecticut's statute specifically addresses the transmission of virtual currency.<sup>93</sup>

Connecticut's mandate that a virtual currency transmitter "hold *virtual currency of the same type* and amount owed or obligated to such other person[]" is a unique choice of language that immensely impacts the ability of virtual currency transmitters to legally conduct business within their borders.<sup>94</sup> Rather than matching outstanding obligations with equivalent liquid assets, a virtual currency business in Connecticut would be required instead to hold an equal amount of whichever type of virtual currency or currencies it had transmitted. To illustrate this point, assume a business transmitted a total of thirty units of a virtual currency to various customers, such a business would now be required to hold thirty units of the same virtual currency in trust.

This example understates the cost and complexity associated with Connecticut's permissible investment rule. For instance, the world's largest virtual currency exchange, "Binance" allows users to hold and exchange numerous types of virtual currencies.<sup>95</sup> In Connecticut, Binance would then be required to match the outstanding value of *each and every* currency it transmits. While Binance could meet such requirements due to its sheer size and transaction volume, the same cannot be said of the vast majority of virtual currency businesses and exchanges that function more or less as small businesses from a balance

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<sup>90</sup> *Id.*

<sup>91</sup> H.B. 7141, 2017 Gen. Assemb., Reg. Sess. (Conn. 2017) (enacted).

<sup>92</sup> 2017 Conn. Acts 17-233 (Reg. Sess.); CONN. GEN. STAT. ANN. § 36a-603 (West 2017).

<sup>93</sup> 2017 Conn. Acts 17-233 (Reg. Sess.); CONN. GEN. STAT. ANN. § 36a-603 (West 2017).

<sup>94</sup> *See generally* 2017 Conn. Acts 17-233 (Reg. Sess.); CONN. GEN. STAT. ANN. § 36a-603 (West 2017) (emphasis added).

<sup>95</sup> The Binance marketplace features hundreds of virtual currencies including the more recognizable Bitcoin, Ethereum, and Ripple. BINANCE, <https://www.binance.com/en/markets> (last visited Mar. 20, 2021); *see also* BINANCE, *About Binance*, <https://www.binance.com/en/about> (last visited June 7, 2021).

sheet perspective. This is a rule of immense consequence when taking into consideration the costs associated with creating virtual currencies such as: electricity consumption, computer hardware, and cooling costs.<sup>96</sup> Not to mention the cost of talent: aspiring virtual currency businesses need to hire individuals with the requisite technical skills, such as coding and advanced mathematics, in order to create or mine digital currencies.<sup>97</sup>

Virtual currencies do not appear out of thin air and cannot simply be printed like the U.S. dollar. Instead, virtual currencies are created technologically through various methods, chief amongst these is mining: the process of creating and verifying bitcoins, or other blockchain based virtual currencies, through the use of high-powered computing processes and complex mathematical formulas.<sup>98</sup> The mining process consumes large amounts of electricity because of the heavy reliance on computing power.<sup>99</sup> In fact, the amount of energy consumed by worldwide bitcoin mining alone “is equivalent to the power uptake of the country of the Czech Republic, with a population of 10.6 million[.]”<sup>100</sup> Further, researchers have indicated that as of 2018, the cost (in terms of electricity) of mining a single bitcoin in the United States was \$4,758 dollars.<sup>101</sup>

Crypto mining companies operate globally seeking out countries with low electricity costs and friendly regulatory environments.<sup>102</sup> Miners prefer countries like Iceland due to the abundance of renewable electricity production and colder climate.<sup>103</sup> This may be problematic

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<sup>96</sup> Sean Williams, *3 Costs Cryptocurrency Miners Need to Know, and the 1 Wildcard That Can Change Everything*, MOTLEY FOOL (May 2, 2018, 9:21AM), <https://www.fool.com/investing/2018/05/02/3-costs-cryptocurrency-miners-need-to-know-and-the.aspx>.

<sup>97</sup> See Toshendra Kumar Sharma, *5 Skill Sets a Blockchain Developer Must Have*, BLOCKCHAIN COUNCIL, <https://www.blockchain-council.org/blockchain/5-skill-sets-a-blockchain-developer-must-have/> (last visited June 7, 2021).

<sup>98</sup> David Easley, Maureen O'Hara, & Soumya Basu, *From Mining to Markets: The Evolution of Bitcoin Transaction Fees*, 134 J. OF FINANCIAL ECONOMICS 91, 92 (2019).

<sup>99</sup> Danny Bradbury, *How Much Power It Takes to Create a Bitcoin*, BALANCE (last updated Apr. 22, 2020) <https://www.thebalance.com/how-much-power-does-the-bitcoin-network-use-391280> (based on the author's calculations, “the bitcoin network in 2020 consumes 120 gigawatts (GW) per second . . . [which] is the equivalent of 156 million horses . . . or 49,440 wind turbines . . . generating power at peak production per second.”).

<sup>100</sup> Aaron Hankin, *Here's How Much It Costs to Mine a Single Bitcoin in Your Country*, MARKETWATCH (May 11, 2018, 9:18AM), <https://www.marketwatch.com/story/heres-how-much-it-costs-to-mine-a-single-bitcoin-in-your-country-2018-03-06>.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* The United States is ranked 41 out of 50 surveyed countries.

<sup>103</sup> *Id.* The colder climate of Iceland is an important factor for crypto miners because it decreases the amount spent on artificial cooling methods.

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for virtual currency enterprises looking to outsource mining to avoid the fees associated with electricity, hardware, and cooling while also attempting to domicile operations in a single state. Outsourcing such functions overseas may cause these companies to run afoul of federal regulations.

Bearing these facts in mind, Connecticut's requirement of holding virtual currencies equal to the amount of outstanding obligations would all but double the already high costs of developing and producing a virtual currency.<sup>104</sup> Virtual currencies do not circulate in the free market in the same manner as traditional fiat currency. This is especially true of companies engaged in the development and issuance of utility tokens, a specific kind of virtual currency that may only be exchanged for a specific good or service.<sup>105</sup> Virtual currencies need to be created, and their creation is an expensive and technically exhaustive process. As such, imposing permissible investment obligations on these entities is redundant and does little to protect consumers but instead drives up transaction costs while driving businesses away from Connecticut and towards more crypto-friendly jurisdictions.

### C. THE BURDENS OF STATE SURETY BOND REQUIREMENTS

In 2017, Washington amended the Uniform Money Services Act to bring virtual currencies within the purview of the state's regulatory regime.<sup>106</sup> The legislature did so by (1) implementing surety bond requirements for online currency exchangers,<sup>107</sup> (2) indirectly defining virtual currency,<sup>108</sup> and (3) creating a multi-state licensing system for virtual currency enterprises.<sup>109</sup>

Washington's surety bond requirements function in a manner similar to the permissible investment provisions discussed above. To make matters worse, Washington still imposes requirements similar to Connecticut law.<sup>110</sup> The requisite surety bond needed for online

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<sup>104</sup> See generally CONN. GEN. STAT. ANN. § 36a-603 (West 2017).

<sup>105</sup> *Utility Token*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/utility%20token>, (last visited Nov. 11, 2019) ("a digital token of cryptocurrency that is issued in order to fund development of the cryptocurrency and that can be later used to purchase a good or service offered by the issuer of the cryptocurrency.").

<sup>106</sup> S.B. 5031, 65th Leg., Reg. Sess. (Wash. 2017); WASH. REV. CODE ANN. § 19.230.010 (West 2017).

<sup>107</sup> WASH. REV. CODE ANN. § 19.230.055 (2017).

<sup>108</sup> See WASH. REV. CODE ANN. § 19.230.010(18) (defining "money transmission").

<sup>109</sup> See WASH. REV. CODE ANN. § 19.230.033 (2017) ("Applicants may be required to make application through a multistate licensing system as prescribed by the director.").

<sup>110</sup> Compare WASH. REV. CODE ANN. § 19.230.200(1)(b) (2017) ("A licensee transmitting virtual currencies must hold like-kind virtual currencies of the same

currency exchangers is calculated by “an amount based on the previous year’s currency exchange dollar volume . . . [and] must be at least ten thousand dollars, and not to exceed fifty thousand dollars.”<sup>111</sup> The director of the Department of Financial Institutions (DFI) also has the discretion to increase the amount of the bond in conformity with the size, performance, and nature of the business.<sup>112</sup> The fees do not stop there; the surety bond must also be maintained for the year following a business’s exit from the state.<sup>113</sup> This means that even if a virtual currency enterprise ceases operations in its entirety, it still must maintain its surety bond with the state for the following year to avoid liability under Washington’s law.<sup>114</sup>

Washington takes an interesting approach to defining virtual currencies that a number of states are likely to follow due to the state’s Uniform Money Services Act and its creation of a multi-state licensing system.<sup>115</sup> The amendments to Washington’s money services act expanded the definition of “money transmission” to include virtual currency.<sup>116</sup> Instead of saying what virtual currency actually is, the law instead only goes as far as saying that virtual currencies have a value equivalent to money.<sup>117</sup> It is true that virtual currencies have an equivalent value to money, but this is not the case for all virtual currencies. Take, for example, the utility tokens briefly mentioned in the above section. One could argue that a token issued in exchange for a later promise of goods or services does not have an equivalent value to money paid, but rather an equivalent value to the good or service being offered. Such nuances are important and are not a stretch of the imagination; one can see these kinds of arguments employed in the earlier discussion of the *Howey* test’s application to virtual currency

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volume as that held by the licensee but which is obligated to consumers . . .”), with CONN. GEN. STAT. ANN. § 36a-603(b) (2017) (“Each licensee that engages in the business of money transmission in this state by receiving, transmitting, storing or maintaining custody or control of virtual currency on behalf of another person shall at all times hold virtual currency of the same type and amount owed or obligated to such other person.”).

<sup>111</sup> WASH. REV. CODE ANN. § 19.230.055(1).

<sup>112</sup> § 19.230.055(6). (The surety bond may be increased “up to a maximum of one million dollars based on the nature and volume of the business activities, the financial health of the company[.]”).

<sup>113</sup> § 19.230.055(4).

<sup>114</sup> *See Id.*

<sup>115</sup> *See* WASH. REV. CODE ANN. § 19.230.033 (West 2012); *see also* UNIF. MONEY SERV. ACT (UNIF. LAW COMM’N 2004).

<sup>116</sup> WASH. REV. CODE ANN. § 19.230.010(18) (West 2017) (“‘Money transmission’ means receiving money or its equivalent value (equivalent value includes virtual currency). . . .” (emphasis added)).

<sup>117</sup> *Id.*

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offerings in *United States v. Zaslavskiy* and *SEC v. Blockvest, LLC*.<sup>118</sup> The problems created by adopting such a broad definition cannot be understated as leaving room for interpretation can lead to more litigation. Moreover, a broad definition is all the more likely to deter virtual currency businesses from participating in the licensing process altogether.

This oversight in Washington's regulatory scheme is unfortunate considering that the state is home to three of the most innovative and prosperous companies in the world: Amazon, Microsoft, and Boeing. Naturally, Washington would like to continue its growth as a technology hub by taking a lead role in blockchain and virtual currency development.<sup>119</sup> Washington's creation of a multi-state licensing system is indeed a positive step for the industry. Its benefits, however, are outweighed by the regulatory burdens imposed by the dual permissible investment maintenance and surety bond requirements, as well as definitional criteria lacking specificity.<sup>120</sup>

#### D. WYOMING: "THE DELAWARE OF DIGITAL ASSET LAW"<sup>121</sup>

Wyoming has earned the reputation as the most "crypto-friendly" state by passing multiple laws centered on blockchain and virtual currency innovation and development.<sup>122</sup> Wyoming began by exempting virtual currency businesses from registering under Wyoming's particularly onerous Money Transmitters Act.<sup>123</sup> A few of these laws are worth highlighting: the application of Uniform

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<sup>118</sup> See *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (seminal case creating an analytical framework for determining what qualifies as a security); see also *United States v. Zaslavskiy*, No. 17CR647(RJD), 2018 U.S. Dist. LEXIS 156574, at \*11-23 (E.D.N.Y. Sept. 11, 2018) and *SEC v. Blockvest, LLC*, No. 18CV2287-GPB(BLM), 2018 U.S. Dist. LEXIS 200773, at \*12-22 (S.D. Cal. Nov. 27, 2018). Both cases are recent examples of courts applying the *Howey* test to virtual currency offerings.

<sup>119</sup> Nat Levy, *Washington Regulators Want to Turn Around State's Bad Rep on Blockchain and Cryptocurrency*, GEEKWIRE (July 6, 2018, 7:00 AM), <https://www.geekwire.com/2018/washington-regulators-want-turn-around-states-bad-rep-blockchain-cryptocurrency/>.

<sup>120</sup> See *Id.*

<sup>121</sup> Caitlin Long, *What Do Wyoming's 13 New Blockchain Laws Mean?*, FORBES (Mar. 4, 2019, 7:29 AM), <https://www.forbes.com/sites/caitlinlong/2019/03/04/what-do-wyomings-new-blockchain-laws-mean/#554c5f4e5fde>.

<sup>122</sup> Barber, *supra* note 54.

<sup>123</sup> See WYO. STAT. ANN. § 40-22-104(a)(vi) (2019); See also WYO. STAT. ANN. §§ 40-22-105-121. Standing out among the burdensome licensing requirements are the requirements that a business must have a minimum net worth of \$25,000, maintenance of a surety bond between \$10,000-\$500,000 upon application, and the maintenance of a statutory trust "having an aggregate market value . . . not less than the aggregate face amount of all outstanding payment instruments[.]".

Commercial Code (UCC) definitional criteria to virtual currencies and provisions concerning digital asset custodial services, The Financial Technology Sandbox Act, The Special Depository Institutions Act, and the Wyoming Utility Token Act.

As previously mentioned, States such as Washington define virtual currencies in an all-inclusive manner.<sup>124</sup> In lieu of adopting such a blanket definition, Wyoming's lawmakers opted to apply Wyoming's UCC definitions to virtual currencies, creating three distinct asset classifications according to a given virtual currency's intended use and purpose.<sup>125</sup> The first class of digital assets, "digital consumer assets" adopts the UCC definition of "general intangibles."<sup>126</sup> The second class, "digital securities" adopts the UCC definition of "securities and investment property."<sup>127</sup> The final class, "virtual currency" falls within the UCC's definition of "money."<sup>128</sup>

Wyoming's definitional approach is a flexible one: it acknowledges the amorphous nature of virtual currencies, brings the myriad of possible adaptations of virtual currencies under a coherent statutory schema, and ultimately provides predictability for virtual currency businesses, consumers, and investors. In contrast, Washington's broad approach treats all virtual currencies the same, and as such, developers are boxed in to treating a digital asset as a digital form of money instead of being able to adapt an offering for a specific purpose. Meanwhile, Wyoming has given innovators in the Fintech space the opportunity to expand existing businesses and develop new applications for virtual

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<sup>124</sup> See WASH. REV. CODE ANN. § 19.230.010(18) (West 2017) (defining "money transmission" as "receiving money or its equivalent value (equivalent value includes virtual currency) to transmit, deliver, or instruct to be delivered to another location, inside or outside the United States, by any means including but not limited to by wire, facsimile, or electronic transfer. 'Money transmission' includes selling, issuing, or acting as an intermediary for open loop prepaid access and payment instruments, but not closed loop prepaid access.").

<sup>125</sup> WYO. STAT. ANN. § 34.1-9-102 (2015).

<sup>126</sup> WYO. STAT. ANN. § 34-29-102(a)(i) (2019); § 34.1-9-102(a)(xlii) (defining "general intangibles" as "any personal property . . . deposit accounts, documents, goods, instruments, investment property . . . includ[ing] payment intangibles and software").

<sup>127</sup> WYO. STAT. ANN. § 34-29-102(a)(ii); WYO. STAT. ANN. § 34.1-8-102(a)(xv) (2015) (defining "Security" as "an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer"); § 34.1-9-102(a)(xlix) (defining "investment property" as "a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract or commodity account").

<sup>128</sup> WYO. STAT. ANN. § 34-29-102(a)(iii) (stating "virtual currency is intangible personal property and shall be considered money, notwithstanding . . . [§] 34.1-1-201(b)(xxiv)"); WYO. STAT. ANN. § 34.1-1-201(b)(xxiv) (2015) (defining "Money" as "a medium of exchange currently authorized or adopted by a domestic or foreign government.").

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currencies, all the while upholding their commitment to consumer protection.

Beginning on January 1, 2020, under the Financial Technology Sandbox Act,<sup>129</sup> developers and entrepreneurs may apply to enter the so called “sandbox,” and upon approval, may experiment with and develop new blockchain and virtual currency business models, without fear of being hamstrung by the state’s regulatory regime.<sup>130</sup> The ingenuity of the Fintech sandbox is its twenty-four month waiver period exempting participants from adhering to certain statutes, regulations, and reporting requirements that would ordinarily extend the timeline for an entity bringing a product to market.<sup>131</sup> The waiver does not offer wholesale immunity—participants are still subject to civil suit, and importantly, “[s]ubject to all criminal and consumer protection laws.”<sup>132</sup> Upon approval, participants are required to submit at minimum a \$10,000 dollar consumer protection bond, which may be adjusted upward or downward at any time to reflect the risk profile of a given product or model.<sup>133</sup>

Wyoming’s legislature is also taking steps to revolutionize the crypto landscape by melding the characteristically decentralized world of virtual currencies with the security and legitimacy of centralized financial institutions by passing into law the Special Purpose Depository Institutions Act<sup>134</sup> and the Digital Asset Custodial Services provision.<sup>135</sup> The creation of these depository institutions fills a gap created by the banks and financial institutions wary of extending their services to

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<sup>129</sup> See generally WYO. STAT. ANN. §§ 40-29-101– 40-29-109.

<sup>130</sup> WYO. STAT. ANN. § 40-29-104(a), (d)-(f)(iii) (2020) (establishing the application must include a criminal background check of the applicant(s), payment of a \$500.00 dollar fee, and a business plan describing the nature of the innovative financial product or service proposed.)

<sup>131</sup> WYO. STAT. ANN. § 40-29-103(a) (2020) (stating “a person who makes an innovative financial product or service available to consumers in the financial technology sandbox may be granted a waiver of specified requirements imposed by statute or rule, or portions thereof, if these statutes or rules do not currently permit the product or service to be made available to consumers.”); § 40-29-102(vii) (“Sandbox period” means the period of time, initially not longer than twenty-four (24) months, in which the commissioner or secretary has authorized an innovative financial product or service to be made available to consumers[.]”)

<sup>132</sup> WYO. STAT. ANN. § 40-29-103(b).

<sup>133</sup> WYO. STAT. ANN. § 40-29-104(h).

<sup>134</sup> See generally Special Purpose Depository Institutions Act, WYO. STAT. ANN. § 13-12-101– 13-12-126.

<sup>135</sup> See generally WYO. STAT. ANN. § 34-29-104 (2020).

blockchain and virtual currency businesses due to stigma and legality concerns.<sup>136</sup>

Under the SPDI Act, Special Purpose Depository Institutions (“SPDIs”) are prohibited from lending, and are not required to carry FDIC insurance.<sup>137</sup> The lending prohibition stands out because it gives burgeoning virtual currency businesses the peace of mind that their financial assets, especially in the vulnerable stages of early development, will be safely held in confidence, instead of indirectly serving as creditors for the bank’s other customers. The legislation provides SPDIs immunity, through the elimination of the FDIC insurance requirement, from a number of federal restrictions on providing custodial services to blockchain and VC businesses.<sup>138</sup> Concerns over waiving traditional FDIC insurance requirements are mitigated by a provision in the SPDI Act requiring all special purpose depository institutions to maintain “unencumbered liquid assets valued at no less than one hundred percent (100%) of its depository liabilities.”<sup>139</sup>

By requiring SPDIs to maintain encumbered liquid assets, Wyoming shifted the burden of funding oversight mechanisms and consumer protection funds from virtual currency enterprises to the financial institutions themselves. Doing so eliminates the expenses presented by programs such as Connecticut’s, where VC entities must hold permissible investments equal to their outstanding obligations, or the extensive surety bond requirements like those present in Washington.<sup>140</sup> As a result, VC entities in Wyoming can dedicate a greater amount of capital to developing a product or business model instead of being stymied financially by consumer protection regulations. Wyoming VC companies also have a greater sense of legitimacy attached

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<sup>136</sup> See Paul Vigna, *Lack of Banking Options a Big Problem for Crypto Businesses*, WALL ST. J. (May 17, 2019), <https://www.wsj.com/articles/lack-of-banking-options-a-big-problem-for-crypto-businesses-11558092600> (discussing that only a few major crypto currency exchanges have cultivated relationships with banks, because banks are “wary of the drug dealers and scammers attracted to the anonymity of cryptocurrency, [and] shun many of the firms behind the electronic money”).

<sup>137</sup> WYO. STAT. ANN. §13-12-103 (2020); § 13-2-103(a) (2020) (“All banks, except special purpose depository institutions, shall obtain insurance of their deposits by the United States and shall subscribe for insurance of deposit accounts by the federal deposits insurance corporation (FDIC).”).

<sup>138</sup> Chad Richman, *Wyoming’s “Crypto-Bank” Charter*, FENWICK & WEST LLP (May 23, 2019), <https://www.fenwick.com/publications/Pages/Wyomings-Crypto-bank-Charter.aspx>.

<sup>139</sup> See WYO. STAT. ANN. § 13-12-105(a) (2019).

<sup>140</sup> See generally CONN. GEN. STAT. ANN. § 36a-603(b) (West 2017); see also WASH. REV. CODE. ANN. § 19.230.055 (West 2017).

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to their name, since businesses taking advantage of SPDIs are backed by a legally sound and reputable financial institution.

In order for VC businesses to take advantage of SPDIs, prospective businesses must demonstrate that adequate anti-money laundering protocols, analogous to those required under federal law, are in place.<sup>141</sup> Applicants must also furnish tangible proof that the business engages in lawful activity.<sup>142</sup>

SF0125's digital asset custodial services provision created a one-of-a-kind system placing unparalleled decision-making authority into the hands of investors and allowing institutional investors to diversify their clientele's portfolios by enabling investments in digital assets.<sup>143</sup> The provision grants banks the authority, pursuant to written agreements with a customer, to enter into a bailment relationship in which the customer maintains full ownership of their digital assets, and can opt to either segregate VC from other assets or consent to the bank conducting transactions with their VC assets.<sup>144</sup> Importantly, under the latter option, the bank must conduct such transactions in strict conformity with the written instructions of the customer.<sup>145</sup>

This provision has an important upshot when considering the fact that federal securities law and SEC regulations require registered investment advisers to deposit client funds with a qualified custodian.<sup>146</sup> Virtual currency investing is predominantly carried out by individual investors on trading platforms such as Binance, Bitfinex and Coinbase.<sup>147</sup> Recently, more mainstream securities trading platforms—like the mobile trading start-up Robinhood—now allow customers to purchase and trade Bitcoin and other popular cryptocurrencies.<sup>148</sup> The limited variety of tradeable cryptocurrencies on Robinhood, however, are unappealing to many crypto investors as these individuals commonly purchase multiple virtual currencies as a hedge, or because

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<sup>141</sup> WYO. STAT. ANN. §13-12-104 (2020).

<sup>142</sup> *Id.*

<sup>143</sup> See Long, *supra* note 121.

<sup>144</sup> See WYO. STAT. ANN. § 34-29-104(d)–(e) (2020).

<sup>145</sup> § 34-29-104(e).

<sup>146</sup> 15 U.S.C. § 80b-18b (2010); 17 C.F.R. § 275.206(4)-2 (2010).

<sup>147</sup> See generally, *Top Cryptocurrency Spot Exchanges*, COINMARKETCAP <https://coinmarketcap.com/rankings/exchanges/> (last visited June 6, 2021).

<sup>148</sup> See ROBINHOOD CRYPTO, <https://robinhood.com/about/crypto> (last visited Mar. 17, 2021) (the mobile trading platform allows users to “[b]uy and sell Bitcoin, Ethereum, Dogecoin, and other cryptocurrencies 24/7 and commission-free[.]”).

of the investors' interest in the penny stocks of the crypto world: "alt coins",<sup>149</sup>

Investing in virtual currencies requires a degree of sophistication akin to the practice of stock picking; rather than throwing darts at a wall of crypto offerings, many traders employ advanced charting and technical analysis strategies.<sup>150</sup> This requisite is especially true when taking into account the high volatility of the virtual currency marketplace.<sup>151</sup> Because of the inherent time considerations, the average investor entrusts wealth managers and institutional investors with managing their funds on their behalf. Unfortunately, the average investor looking to diversify their third-party managed investments is not yet afforded the opportunity to incorporate digital assets into their portfolios, with the exception of the few brokerage firms currently offering investments in bitcoin futures.<sup>152</sup> The SPDI Act now opens the door for brokers looking to diversify their clients' portfolios with investments in digital assets, without fear of running afoul of SEC Rule 206(4)-2.<sup>153</sup> Furthermore, customers will have freedom of choice to a

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<sup>149</sup> See ROBINHOOD CRYPTO, *supra* note 148; See generally, CB INSIGHTS, *What are Stablecoins?*, (Feb. 16, 2021), <https://www.cbinsights.com/research/report/what-are-stablecoins/#:~:text=In%20general%2C%20a%20stablecoin%20is,value%20of%20a%20underlying%20asset.&text=Many%20stablecoins%20are%20pegged%20at,can%20be%20traded%20on%20exchanges> (discussing "stablecoins," "virtual currencies which are pegged to the value of gold, the US dollar, or other stable commodities or currencies. Many crypto investors hedge their positions in more volatile virtual currencies with investments in stablecoins); and Daniel Van Boom, *Beyond Bitcoin: Inside the insane world of altcoin cryptocurrencies*, CNET, (Apr. 13, 2021), <https://www.cnet.com/features/beyond-bitcoin-the-wild-world-of-altcoin-cryptocurrency-trading/> (providing background on alt coins and explaining the rampant speculation in such offerings by retail investors).

<sup>150</sup> See generally James Chen, *Stock Pick*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/stockpick.asp> (last updated Dec. 23, 2020) (Stock picking is the process employed by traders and investors where a "systematic form of analysis [is used] to conclude that a particular stock will make a good investment[.]"); and see GEMINI, *Technical Analysis and Crypto*, <https://www.gemini.com/cryptopedia/technical-analysis-bitcoin-and-crypto> (last updated May 27, 2021).

<sup>151</sup> See generally YAHOO FINANCE, *Most Volatile Cryptos*, <https://finance.yahoo.com/u/yahoo-finance/watchlists/crypto-volatility-high/> (last visited Mar. 17, 2021).

<sup>152</sup> See generally TD AMERITRADE, *Bitcoin Futures*, <https://www.tdameritrade.com/investment-products/futures-trading/bitcoin-futures.page> (last visited Mar. 17 2021); Cf. CHARLES SCHWAB, *Bitcoin: Does It Have a Place in Your Portfolio?*, <https://www.schwabassetmanagement.com/content/bitcoin-does-it-have-place-your-portfolio> (Apr.1, 2021).

<sup>153</sup> WYO. STAT. ANN. §§ 13-12-101-13-12-126. SEC Rule 206(4)-2 states that it is a "fraudulent, deceptive or manipulative act, practice, or course of business" for a registered investment advisor to maintain custody of client funds unless a "qualified custodian maintains those funds and securities[.]" 17 C.F.R. 275.206(4)-2(a)(1) (2010).

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degree rarely seen in fiduciary investor-manager relationships due to the specific written consent requirements proscribed under the SPDI Act.<sup>154</sup>

The Utility Token Act (UTA) concerns virtual currencies created solely for consumptive purposes.<sup>155</sup> “Consumptive purposes” means that the given virtual currency may only be exchanged for a specifically proscribed good or service; a holder of a utility token purchases the rights to whatever that token is being sold for.<sup>156</sup> As discussed earlier, the laws in Connecticut and Washington do not adequately facilitate the growth of utility token centric business models because of the broad definitional criteria and onerous licensing requirements present within those statutes.<sup>157</sup> Virtual currencies subject to registration under different subsections of the Financial Technology Sandbox Act may not masquerade as a utility token issuer to take advantage of the UTA’s exemptions from state securities and money transmitter registration.<sup>158</sup> Exemption from registration requires utility token developers and sellers to abide by a set of stringent rules: utility tokens may not be marketed as a financial investment, cannot be re-sold by the buyer until the token can be used for its intended purpose, and the seller of the token must take reasonable steps to ensure that buyers are not purchasing a utility token as a financial investment.<sup>159</sup>

One may ask what value utility tokens serve when their value is pegged to a particular service or good, rather than having the potential to appreciate in value like a traditional asset. But utility tokens provide a different kind of benefit for businesses and consumers alike because of their potential to generate interest in a particular good or service; a streamlined method of capital formation in the form of crowd sourcing investments in a product or business model.<sup>160</sup> Utility tokens also provides businesses with an accurate tool for tracking inventories and

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<sup>154</sup> See WYO. STAT. ANN. § 34-29-104(e) (2020).

<sup>155</sup> WYO. STAT. ANN. § 34-29-106 (2019) (“‘Consumptive’ means a circumstance when a token is exchangeable for, or provided for receipt of, services, software, content or real or tangible personal property, including rights of access to services, content or real or tangible personal property[.]”).

<sup>156</sup> *Id.*

<sup>157</sup> See *supra* Part III.

<sup>158</sup> John Biggs, *Wyoming works to make some crypto tokens exempt from regulation*, TECHCRUNCH, (Mar. 7, 2018, 1:12 PM), <https://techcrunch.com/2018/03/07/wyoming-works-to-make-some-crypto-tokens-exempt-from-regulation/>.

<sup>159</sup> See § 34-29-106(a) – (f).

<sup>160</sup> See generally David Mack, *Token Based Funding*, DEFI PRIME (Apr. 29, 2020), <https://defiprime.com/token-based-funding>; Gigi Levy-Weiss, *The Future of Fundraising? What we Need to Fix About Token Investing*, NFX <https://www.nfx.com/post/token-investing/> (last visited June 5, 2021).

projecting expenditures.<sup>161</sup> As such, creating a legal framework centered on utility tokens is a practical way to encourage entrepreneurial and small business inclusion into Wyoming's virtual currency industry, and encourages consumers to become directly involved in the process of propping up businesses within their community.

Bearing this in mind, it is important to acknowledge the prevailing views amongst regulators as it pertains to initial coin offerings (ICOs). The federal government's crackdown on virtual currencies stems largely from fraudulent initial coin offerings (ICOs) premised on launching a unique virtual currency or business offering.<sup>162</sup> The difficulty presented by ICOs is that the underlying business or offering is not subject to vetting through an application, licensing, or registration regime that a publicly offered company would normally be subjected to.<sup>163</sup> Instead, in the virtual currency world, all that is needed is a website and an idea. Consequently, ICOs are commonly regarded as just another Ponzi scheme or a new kind of digitized snake oil.<sup>164</sup>

This is where the true value of Wyoming's Utility Token Act comes into play: by virtue of creating barriers to entry into the state's economy, Wyoming's regulatory enforcement arm can now ensure that utility token issuers are legitimate and in good standing. The vetting process created by the Utility Token Act may now have the downstream effect of boosting consumer and investor confidence, which in turn creates an environment where burgeoning small businesses and entrepreneurs can pursue their unique business models with greater ease.

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<sup>161</sup> The blockchain technology underlying utility tokens can allow businesses to more efficiently manage supply chain and inventory. Sharon Edelson, *Blockchain Could Transform Retail, From Supply Chain and Inventory Management to Product Provenance*, FORBES (May 3, 2021, 11:00 AM), <https://www.forbes.com/sites/sharonedelson/2021/05/03/esg-investing-in-blockchain-and-cryptocurrency-decoded/?sh=163f49521c2f>.

<sup>162</sup> See generally, Kate Rooney, *In Bigger Crackdown of Crypto Abuses, SEC Goes After Unregistered Coin Offerings*, CNBC (Nov. 19, 2018, 3:18 PM), <https://www.cnbc.com/2018/11/16/in-crackdown-of-crypto-sec-goes-after-unregistered-coin-offerings.html>.

<sup>163</sup> See Connor Sephton, *Five big problems with initial coin offerings - and how to avoid them*, CURRENCY.COM (Nov. 15, 2019, 7:35 PM), <https://currency.com/five-big-problems-with-initial-coin-offerings-and-how-to-avoid-them>.

<sup>164</sup> Ben Dickson, *Can You Trust Crypto-Token Crowdfunding?*, TECHCRUNCH (Feb. 12, 2017), <https://techcrunch.com/2017/02/12/can-you-trust-crypto-token-crowdfunding/>.

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## E. COLORADO: CRYPTO ECONOMIC SYSTEMS HUB

Along with Wyoming, Colorado is the only other state implementing a virtual currency regulatory scheme that attempts to facilitate the assimilation of virtual currency businesses within their borders without imposing redundant registration requirements.<sup>165</sup> The primary goal underlying the Colorado Digital Token Act (SB 19-023)<sup>166</sup> is to “enable Colorado businesses that use cryptoeconomic systems to obtain growth capital to help grown and expand their businesses . . . and helping make Colorado a hub for companies that are building new forms of decentralized ‘Web 3.0’ platforms and applications.”<sup>167</sup> Colorado’s Digital Token Act embraces a definition of digital tokens created for consumptive purposes similar to the Wyoming Utility Token Act: it seeks to implement a system in which businesses may utilize “[c]rowdfunding consumer goods platforms [to] provide a means for companies and entrepreneurs to acquire growth capital and customers by preselling the right to receive consumer goods before the goods are ready to be sold or used[.]”<sup>168</sup> The Act also created two exemptions from the Colorado Securities Act (CSA),<sup>169</sup> the issuer exemption, and the licensing exemption.<sup>170</sup>

In 2016, Colorado passed into law the Colorado Crowdfunding Act with the hopes of courting start-up companies and accelerating small business growth in the state.<sup>171</sup> While the Crowdfunding Act applies specifically to securities-issuing companies, it nonetheless provided the impetus for the crowdfunding goals underlying Colorado’s Digital Token Act. The Crowdfunding Act acknowledges the obstacles presented by the CSA’s expensive and often confusing registration requirements as well as the restrictions placed on crowdfunding by the CSA.<sup>172</sup> Importantly, when crafting the Digital Token Act, lawmakers already had at their disposal the legislative findings and underlying policy initiative to craft a niche crowdfunding application. The Digital Token Act aptly embraced the state’s crowdfunding goals by allowing small

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<sup>165</sup> See COLO. REV. STAT. ANN. § 11-51-308.7(c) West (2019).

<sup>166</sup> § 11-51-308.7.

<sup>167</sup> § 11-51-308.7(c).

<sup>168</sup> § 11-51-308.7(2)(a)(V). “Crowdfunding” refers to the process of “raising money online through small contributions from a large number of investors” which allows small companies to access the necessary capital for starting or expanding a business. § 11-51-308.5(2)(b)(II)-(III).

<sup>169</sup> COLO. REV. STAT. ANN. § 11-51-301 (West 2018); COLO. REV. STAT. ANN. § 11-51-302 (West 2018).

<sup>170</sup> § 11-51-308.7(3)(a); § 11-51-308.7(3)(b).

<sup>171</sup> COLO. REV. STAT. ANN. § 11-51-308.5 (West 2016).

<sup>172</sup> See § 11-51-308.5(2)(b)(I)-(II).

companies to raise capital through the issuance of virtual currencies created for consumptive purposes, which could later be exchanged for a consumer good pegged to the value of the issued consumptive token.

Under the Digital Token Act, ambitious entrepreneur's with limited capital and sparse credit history, now have access to a cheaper and less redundant regulatory scheme, which in turn allows these entrepreneurs to crowdfund through the issuance of a consumptive digital token. By way of example, take Jonathan, a twenty-three year old entrepreneur who wants to start a clothing line consisting of three different sweatshirt designs. Jonathan does not have the finances or credit worthiness necessary to procure the necessary materials and equipment to begin producing his sweatshirts.

In theory, the Digital Token Act would enable Jonathan to create a digital token which could be offered to consumers who could later exchange those tokens for sweatshirts. Here, the innovation is that creating such a token is far cheaper than creating the supply for the product (i.e. the sweatshirts) prior to having any demand. Now Jonathan can sell the token which will: 1) provide the entrepreneur with the necessary capital to make his sweatshirts, and 2) give the entrepreneur an accurate picture of his sweatshirt production needs. The Digital Token Act could also have a profound effect on another burgeoning area in Colorado: the industry.

The Digital Token Act will likely play a significant role in facilitating the continued growth of Colorado's burgeoning recreational cannabis industry, as many companies are beginning to utilize blockchain technology to "monitor[] the growth and shipping of cannabis, referred to in the industry as 'seed-to-sale-tracking.'"<sup>173</sup> Cannabis companies shifting to immutable ledger tracking systems now have the opportunity of using the same ledger technology as a bedrock for a consumptive token that could seamlessly rest upon the same technology already in use for other business functions, such as the crowd funding example discussed above.

In addition to aiding business formation, the Digital Token Act also protects those seeking to utilize consumptive tokens by exempting issuers of consumptive tokens from Colorado's stringent securities registration and broker-dealer/investment advisor regulatory and licensure schemes.<sup>174</sup> The Colorado Securities Act (CSA) prohibits individuals from selling investment securities without properly filing

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<sup>173</sup> Chris Chafin, *Why Weed Companies Are Embracing Blockchain*, ROLLING STONE (Dec. 10, 2018, 4:23 PM), <https://www.rollingstone.com/culture/culture-features/weed-companies-blockchain-cryptocurrencies-760151/>.

<sup>174</sup> See generally COLO. REV. STAT. ANN. § 11-51-301 (West 2018).

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with the state's securities commissioner.<sup>175</sup> The securities commissioner has wide discretion in the registration process by virtue of setting the registration fee and having the power to hold proceeds from a securities sale in escrow until a determined threshold amount of the security is sold.<sup>176</sup> Another nuance of the issuer exemption that sets Colorado's Token Act apart from Wyoming is the required buyer acknowledgement.<sup>177</sup> Under the Colorado Act, the buyer of a consumptive token must take responsibility for their purchase, thus indirectly shielding the issuer of that token.<sup>178</sup> On the other hand, Wyoming's Utility Token Act forces the issuer to properly vet the sale of a consumptive token by taking "reasonable precautions" to ensure consumptive tokens are not being purchased as a speculative vehicle, and as such, issuers may be liable for a buyer's wrongful purchase.<sup>179</sup>

The CSA requires broker-dealers and investment advisers to properly register with the state's securities commissioner.<sup>180</sup> In addition to filing notice with the state, individuals registering must pay an initial and annual licensing fee.<sup>181</sup> Absent exemption, virtual currency developers in Colorado seeking to comply with state law risk running afoul of federal securities law because Colorado's licensing process tracks federal requirements under the Securities Exchange Act of 1934.<sup>182</sup>

The licensing exemption allows an issuer of consumptive tokens to bypass licensing under the CSA so long as the issuer is engaged in the sale of consumptive tokens, properly files a notice of intent with the state securities commissioner, and provides reasonable oversight to ensure the issued token is properly used for consumptive purposes.<sup>183</sup> Interestingly, the licensing exemption contains a provision allowing

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<sup>175</sup> *Id.*

<sup>176</sup> *See* COLO. REV. STAT. ANN. § 11-51-707(3)(a) (vesting power to set registration fee), *and see* § 11-51-302(5) (2018) (vesting escrow discretion).

<sup>177</sup> *Compare* COLO. REV. STAT. ANN. § 11-51-308.7(3)(a)(V)(C) (West 2019) ("The initial buyer provides a knowing and clear acknowledgement that the initial buyer is purchasing the digital token with the primary intent to use the digital token for a consumptive purpose and not for a speculative or investment purpose."), *with* WYO. STAT. ANN. § 34-29-106(b)(iii)(D) (2019) ("The developer or seller takes other reasonable precautions to prevent an initial buyer from purchasing the token as a financial investment.").

<sup>178</sup> COLO. REV. STAT. ANN. § 11-51-308.7(3)(a)(V)(C).

<sup>179</sup> WYO. STAT. ANN. § 34-29-106(b)(iii)(D).

<sup>180</sup> COLO. REV. STAT. ANN. § 11-51-401(1)-(4) (1999).

<sup>181</sup> *See* COLO. REV. STAT. ANN. § 11-51-404 (2015).

<sup>182</sup> *Compare* COLO. REV. STAT. ANN. § 11-51-402(1)(a) (exempting broker-dealer's registered under Securities Exchange Act of 1934 from state registration requirements), *with* 15 U.S.C. § 77f(a)-(b) (2015).

<sup>183</sup> *See* COLO. REV. STAT. ANN. § 11-51-308.7(3)(b) (2019).

virtual currencies developed in Colorado, other states, and foreign jurisdictions to enter into Colorado's market, or for Colorado-based issuers to enter into domestic and foreign jurisdictions.<sup>184</sup> This is made possible through power granted to the Securities Commissioner allowing that individual to enter into agreements with regulators from other states, the federal government, or regulators from foreign jurisdictions.<sup>185</sup>

By allowing such agreements, Colorado's legislature legitimized a long-term approach that will allow Colorado to assert its role as a crypto economic systems hub. Now, as other jurisdictions seek to incorporate virtual currencies into their financial markets, Colorado will be able to insert its digital asset products into other jurisdictions, so long as regulators from different jurisdictions enter into agreements with one another. At the same time, Colorado can bolster its crypto economy by having a say in the kinds of virtual currencies entering into their market.

Colorado's Digital Token Act does not go as far as Wyoming's multi-faceted approach, but it is undoubtedly a step in a more innovative direction. Allowing a market for consumptive purpose utility tokens with the overall vision of facilitating a growing entrepreneurial and start-up culture is a coherent model that other states may seek to emulate. This is especially true for those states looking to innovate their economies and grow their financial technology sectors.

#### PART IV. THE RIGHT SIDE OF THE COIN

Change at the federal level is likely to remain stagnant for the coming years considering Congress's demonstrated lack of knowledge when it comes to rudimentary technological concepts.<sup>186</sup> Until the knowledge gap shrinks, the federal stance will remain grounded in an enforcement paradigm. As such, states will be responsible for driving legislative initiatives in the cryptocurrency and blockchain industries. In this context, states will always have the overarching goal of protecting their constituents from fraudulent virtual currency offerings. As we have seen up until this point, this is not a zero-sum game; states do not have to choose between innovation and stifling regulation in the

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<sup>184</sup> § 11-51-308.7(3)(d).

<sup>185</sup> *Id.*

<sup>186</sup> See, e.g., Anna Hensel, *Congress Lacks Tech Knowledge to Properly Question Google CEO Sundar Pichai*, VENTUREBEAT (Dec. 11, 2018), <https://venturebeat.com/2018/12/11/congress-lacks-tech-knowledge-to-properly-question-google-ceo-sundar-pichai/>.

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name of consumer protection, where only a miniscule amount of VC enterprises can satisfy licensing and registration requirements.

As Wyoming and Colorado have demonstrated, crypto friendly regulatory schemes are achievable through a balancing of consumer protection measures and provisions encouraging existing and aspiring virtual currency enterprises to participate in their local economies. Notwithstanding, the difficulties in achieving this balance stem largely from nuances in defining virtual currencies, as well as a failure to appreciate why businesses and consumers gravitate towards these currencies in the first place. The explosion in popularity stems largely from the simultaneous growing distrust in mainstream financial institutions and the increasing public awareness of data privacy.<sup>187</sup> Meanwhile, the more investment-minded recognize an opportunity to prop up a new kind of asset class, which, depending on the design and purpose of the digital asset, can be traded in currency, securities, or commodities markets.

From a business perspective, entrepreneurs and the libertarian-minded have recognized an opportunity to tap into these growing consumer sentiments, as well as the chance to launch business platforms that would not have been feasible through the traditional models of business planning and development.<sup>188</sup> Regardless of the motivations, technological change will continue to shape the American business landscape and consumer preferences. It is up to the states whether to harness the power of these changes or to try to meld the ever-shifting landscape to existing regulatory frameworks.

On the “right side of the coin” are the Wyoming and Colorado approaches. These frameworks acknowledge the tidal change in technology and seek to embrace the potential economic windfall that virtual currency businesses and related technologies can bring into their borders. States like Wyoming have accepted, and wholeheartedly embraced, the reality the reality that the inherently amorphous nature of crypto currencies is best served by a malleable framework and broad definitional criteria that gives virtual currency developers the power to conform their business model to a digital asset class that appropriately

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<sup>187</sup> See Kate Rooney, *After The Crisis, a New Generation Puts Its Trust in Tech Over Traditional Banks*, CNBC (Sept. 14, 2018, 2:23 PM), <https://www.cnbc.com/2018/09/14/a-new-generation-puts-its-trust-in-tech-over-traditional-banks.html>; see also Louis Menand, *Why Do We Care So Much About Privacy?*, (Jun. 11, 2018), <https://www.newyorker.com/magazine/2018/06/18/why-do-we-care-so-much-about-privacy>.

<sup>188</sup> See Andrey Sergeenkov, *DeFi is the New Lemonade Stand*, ENTREPRENEUR (Mar. 16, 2021), <https://www.entrepreneur.com/article/366444>.

serves their desired purpose.<sup>189</sup> In doing so, the likelihood of litigation over whether a digital asset complies with a specific statutory definition is reduced because VC developers and issuers are opting-in to an asset class, rather than having the class imposed upon their business.<sup>190</sup>

To truly catalyze the assimilation of virtual currencies into the economic lexicon, states would be well served to follow in Wyoming's path. Recognizing the role that traditional financial institutions can play in the growth of the virtual currency industry dampens the stigma associated with such technologies while buttressing consumer protection goals and economic innovation.<sup>191</sup> Statutory devices permitting the licensing of Special Purpose Depository Institutions (SPDIs), and giving financial institutions the option to serve as qualified custodians gives consumers and VC businesses the peace of mind that their assets will be well protected and fosters an environment of trust that could shift virtual currencies from being a niche device, to something that the average consumer would be interested in taking advantage of.

In all likelihood, state legislators and regulators will remain dubious of enacting wholesale virtual currency schemes. What is more likely is the embrace of utility tokens, or novel applications such as California's proposed bill authorizing cannabis businesses to pay state and local taxes via stablecoins.<sup>192</sup> Consumptive purpose tokens can drive the growth of small business and entrepreneurial activity within their borders.<sup>193</sup> Importantly, states can take this action regardless of their existing industries, demographics, and access to natural resources. Technology-based businesses can generally exist in all environments and may be interwoven into existing marketplaces or may diversify state economies that have long relied on decaying industries like manufacturing and coal mining.<sup>194</sup>

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<sup>189</sup> See generally WYO. STAT. ANN. § 34.1-9-102 (2019).

<sup>190</sup> See generally *United States v. Zaslavskiy*, No. 17CR647(RJD), 2018 U.S. Dist. Lexis 156574, \*1 (E.D.N.Y. Sept. 11, 2018); and *SEC v. Blockvest, LLC*, No. 18CV2287-GPB(BLM), 2018 U.S. Dist. LEXIS 200773, \*1 (S.D. Cal. Nov. 27, 2018).

<sup>191</sup> See Vigna, *supra* note 136 (discussing the hesitancy of banks to embrace cryptocurrencies due to their prevelant association with money laundering and other illicit activities).

<sup>192</sup> See *supra* note 70.

<sup>193</sup> Karen Graham, *Sizing up the financially underserved market* FINTECH FUTURES (Apr. 15, 2020), <https://www.fintechfutures.com/2020/04/sizing-up-the-financially-underserved-market/>.

<sup>194</sup> See, e.g., Kris Maher, *In Pro-Trump West Virginia Coal Country, the Jobs Keep Leaving*, WALL ST. J. (Oct. 28, 2019), <https://www.wsj.com/articles/in-pro-trump-west-virginia-coal-country-the-jobs-keep-leaving-11572269967>.

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Allowing existing and aspiring businesses to utilize consumptive tokens to fundraise and streamline business activities defies the normative practices which have characteristically served the wealthy. While members of the upper class more readily obtain capital through traditional lending, individuals of lesser privilege now have the opportunity to access capital through grassroots modicums. This trend has the potential to serve as a tool in rejuvenating the economies of historically impoverished and financially-underserved areas of the country.<sup>195</sup> In sum, permitting the development of technologically efficient devices such as consumptive tokens that bring with them the benefits of immutable ledger technology may be the answer to the economic stagnancy taking hold over different regions of the United States.

## Part V. Conclusion

This comment advances the adoption of more “crypto-friendly” regulatory schemes like those in force in Wyoming and Colorado. First, this comment grappled with the varying regulatory approaches of the SEC and FinCEN, highlighting the federal government’s enforcement-based paradigm, and how differing definitional criteria amongst federal agencies shapes their respective regulatory approaches. Next, this comment analyzed the legislative schemes enacted in several different states, with a focus on emphasizing coherently defining digital assets and the potential deleterious effects of imposing traditional money transmitter licensing requirements such as permissible investment holdings and surety bond requirements on virtual currency businesses.

While these requirements exist to protect consumers, states like Wyoming and Colorado have been able to advance a framework that adequately balances the interests in consumer protection while injecting new life into their local economies. Regardless of approach, it is clear that while the federal government seeks to stamp out fraud and the use of virtual currencies for illicit purposes, state legislatures and regulators need not choose between protecting its consumers and taking advantage of the potential economic windfall associated with virtual currencies and related technologies.

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<sup>195</sup> See generally Univ. of Mich., *New index ranks America’s 100 most disadvantaged communities*, (Jan. 30, 2020), <https://poverty.umich.edu/2020/01/30/new-index-ranks-americas-100-most-disadvantaged-communities/>.