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## Virtual Currency, Not a Currency?

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## VIRTUAL CURRENCY, NOT A CURRENCY?

*By Gary E. Kalbaugh*

### VIRTUAL CURRENCY

Virtual currency continues to seize the imagination of the public<sup>1</sup>, economists<sup>2</sup>, lawyers<sup>3</sup>, governments<sup>4</sup>, supranational organizations<sup>5</sup>, and technology experts.<sup>6</sup> In addition to providing a payment medium<sup>7</sup>, as virtual currencies like Bitcoin have already done<sup>8</sup>, the technology underlying virtual currency can be used for items as versatile as escrow arrangements<sup>9</sup>, contractual performance through “smart contracts”<sup>10</sup>, and public crypto-ledgers securely tracking and memorializing a broad range of occurrences.<sup>11</sup>

The history and structure of virtual currency has been thoroughly addressed elsewhere.<sup>12</sup> As succinctly described by one observer:

Bitcoins are scarce digital commodities that enable parties to transmit messages over a network that serves as a universal public ledger. This ledger, also known as the block chain, records the messages and is a common feature of all cryptocurrencies, so named because they use computational methods that securely transmit messages. Software developers are currently creating applications that use bitcoins to enable transactions that are automated, disintermediated (peer to peer), and secure. These transactions are often referred to “smart contracts” and are designed to take the form of decentralized exchange not reliant upon intermediaries such as banks, exchanges, or dealers.<sup>13</sup>

While virtual currencies such as Bitcoin have attributes of more traditional currency, i.e., being mediums of exchange, units of account, and stores of value, none are legal tender in any country.<sup>14</sup>

### Legal Treatment by the CFTC

Commentators have asked whether virtual currency is in a category of instrument that is regulated by the CFTC, namely, is it a foreign currency, or a commodity.<sup>15</sup> As noted in the table below, the regulatory consequences of a categorization of a virtual currency, such as Bitcoin as a commodity versus categorization as a currency, are significant.

#### *Commodity*

That virtual currencies such as Bitcoin are commodities is beyond doubt, due to the exceptionally broad definition of “commodity” in the Commodity Exchange Act. It is so broad as to encompass a laundry list of specified agricultural products and “all other goods and articles . . . and all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in.”<sup>16</sup> However, classification of something as a commodity is not sufficient to determine the extent of the CFTC’s jurisdiction over it since the Commodity Exchange Act limits or precludes CFTC jurisdiction over certain categories of commodities.<sup>17</sup>

### *Currency*

The authority of Congress to designate legal tender is well established in U.S. law.<sup>18</sup> However, this question is distinct from what is a currency under the Commodity Exchange Act since “currency” therein is not limited to legal tender in the United States. The definitions in the Commodity Exchange Act of “foreign exchange forwards” and “foreign exchange swaps” reference two different currencies, implying that one is foreign to the other and not necessarily that one or both are issued by a sovereign:

#### (24) Foreign exchange forward

The term “foreign exchange forward” means a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.

#### (25) Foreign exchange swap

The term “foreign exchange swap” means a transaction that solely involves—

(A) an exchange of 2 different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange; and

(B) a reverse exchange of the 2 currencies described in subparagraph (A) at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange.<sup>19</sup>

Nonetheless, the CFTC appears to have taken the stance that virtual currencies such as Bitcoin are, from a CFTC regulatory standpoint, commodities (not specifically currency). In an enforcement action against Coinflip, operator of a Bitcoin option exchange known as Derivabit,<sup>20</sup> the CFTC noted that Bitcoin is:

a “virtual currency,” defined here as a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value, but does not have legal tender status in any jurisdiction. Bitcoin and other virtual currencies are distinct from ‘real’ currencies, which are the coin and paper money of the United States or another country that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance.<sup>21</sup>

In addition to making this distinction between Bitcoin and what the CFTC termed “real currencies,” the CFTC also implicitly conceded that the so-called “trade option” exemption would have been available to Coinflip, had Coinflip met the requirements.<sup>22</sup> This exemption is only available with respect to an off-exchange commodity option and is not available with respect to an off-exchange foreign currency option.<sup>23</sup> Therefore, although it

could be argued that the CFTC has conceded that “virtual currency” may fall into a more generic colloquial understanding of “currency,” it appears that the CFTC has concluded that virtual currency is a commodity and not a currency for the specific purposes of the Commodity Exchange Act.<sup>24</sup>

### **Legal Treatment by Other Parties**

The Financial Crimes Enforcement Network has, in the context of anti-money laundering regulations, defined currency as:

The coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance. Currency includes U.S. silver certificates, U.S. notes and Federal Reserve notes. Currency also includes official foreign bank notes that are customarily used and accepted as a medium of exchange in a foreign country.<sup>25</sup>

As with the CFTC, the Financial Crimes Enforcement Network emphasizes that currency is “legal tender.”

The Internal Revenue Service has also adopted the view that virtual currency is not currency for the purposes of the Internal Revenue Code as expressed in the “Frequently Asked Questions” section of an advisory on virtual currency:

Q-1: How is virtual currency treated for federal tax purposes?

A-1: For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.

Q-2: Is virtual currency treated as currency for purposes of determining whether a transaction results in foreign currency gain or loss under U.S. federal tax laws?

A-2: No. Under currently applicable law, virtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes.<sup>26</sup>

On the other hand, in ordinary parlance a “currency” can be defined as “something (as coins, treasury notes, and banknotes) that circulates as a medium of exchange.”<sup>27</sup>

And, in one context related to anti-money laundering statutes and regulations, Bitcoin has been determined to be money, albeit not currency<sup>28</sup>:

*First, “money” in ordinary parlance means “something generally accepted as a medium of exchange, a measure of value, or a means of payment.”<sup>29</sup> Bitcoin clearly qualifies as “money.” . . . Bitcoin can be easily purchased in exchange for ordinary currency, acts as a denominator of value, and is used to conduct financial transactions.<sup>30</sup>*

Last, it has been noted by a magistrate judge that “Bitcoin is an electronic form of currency unbacked by any real asset and without specie, such as coin or precious metal.”<sup>31</sup>

### **What is the Impact of the CFTC’s Determination That Virtual Currency is a Commodity?**

The table below describes the differences in the CFTC’s jurisdiction with respect to foreign exchange and commodities in general. In simple terms, the net effect of the CFTC asserting that virtual currency such as Bitcoin is a general commodity and not a currency is: (1) a preclusion of securities exchanges from listing Bitcoin options; (2) greater oversight and regulations applicable to Federally regulated entities such as banks and securities broker-dealers trading physically-settled virtual currency swaps and forwards; (3) the availability with respect to Bitcoin of a “trade option” exception allowing for certain off-exchange options to be largely unregulated<sup>32</sup>; and (4) robust anti-fraud and market manipulation authority with respect to spot transactions at the expense of regulatory authority over certain leveraged or margined transactions between retail customers and entities other than certain Federally regulated financial institutions.<sup>33</sup>

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Comparison of CFTC's Jurisdiction Over Foreign Exchange and Commodities in General		
<u>CFTC Jurisdiction Over:</u>	<u>Foreign Exchange</u>	<u>Commodities in General</u>
<b>Futures</b>	Yes <sup>34</sup>	Yes <sup>35</sup>
<b>Exchange-Traded Options</b>	Yes, unless traded on securities exchange. <sup>36</sup>	Yes <sup>37</sup>
<b>Off-exchange Options</b>	Yes, treated as swaps <sup>38</sup> and with additional CFTC jurisdictional basis if traded with a retail customer (i.e., a person that is not an "eligible contract participant" <sup>39</sup> ) and an entity that is not regulated by a "Federal regulatory agency". <sup>40</sup>	Yes, unless qualifying as a "trade option". <sup>41</sup>
<b>Forwards<sup>42</sup></b>	Yes, treated as swaps for purposes of CFTC swaps transaction reporting and CFTC "external business conduct" requirements will apply to any swap dealer or major swap participant that is a party to a foreign exchange forward. <sup>43</sup>	Yes, (1) if not physically settled within 28 days <sup>44</sup> and if entered into with or offered to a retail counterparty <sup>45</sup> on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis <sup>46</sup> , or (2) with respect to manipulation and fraud. <sup>47</sup>
<b>Swaps</b>	Yes <sup>48</sup> but, if physically-settled, it will be treated as a swap solely for the purposes of CFTC swaps transaction reporting and, with respect to any party that is a swap dealer or major swap participant, the application of CFTC "external business conduct" requirements. <sup>49</sup>	Yes <sup>50</sup>
<b>Spot</b>	Yes, if entered into with or offered to a retail counterparty by an entity that is not regulated by a "Federal regulatory agency" <sup>51</sup> on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis <sup>52</sup> (if not physically settled within 2 days <sup>53</sup> see "Forwards" <i>supra</i> ).	Yes, with respect to manipulation and fraud <sup>54</sup> (if not physically settled within 28 days see "Forwards" <i>supra</i> ).

## CONCLUSION

The CFTC's treatment of virtual currency, such as Bitcoin, as a commodity and not a currency generally augments the scope of the CFTC's jurisdiction.<sup>55</sup> However, grounding its view in the fact that no virtual currency has "legal tender status in any jurisdiction"<sup>56</sup> results in regulatory volatility since, by the mere act of designating a virtual currency as legal tender, any sovereign can undermine the CFTC's (and the Financial Crimes Enforcement Network's and the Internal Revenue Service's) primary argument for a virtual currency, such as Bitcoin, being deemed to be a commodity and not a currency. In making future policy in this area, in the absence of Congressional action, regulators may consider alternative bases for defining a virtual currency such as Bitcoin as a commodity.

A better approach may be to take the view that Bitcoin should be deemed to be a currency since, based on function, structure, and the common definition of currency, there is a sound basis for this conclusion.

<sup>1</sup> For just a few representative examples of the many news reports on virtual currency, see e.g., Sebastian Mallaby, *A Vision of Money's Digital Future, From Cash to Code*, WALL ST. J. (Dec. 9, 2015), <http://www.wsj.com/articles/a-vision-of-moneys-digital-future-from-cash-to-code-1449679041> (subscription required); Nathaniel Popper, *Decoding the Enigma of Satoshi Nakamoto and the Birth of Bitcoin*, N.Y. TIMES (May 15, 2015), [http://www.nytimes.com/2015/05/17/business/decoding-the-enigma-of-satoshi-nakamoto-and-the-birth-of-bitcoin.html?\\_r=0](http://www.nytimes.com/2015/05/17/business/decoding-the-enigma-of-satoshi-nakamoto-and-the-birth-of-bitcoin.html?_r=0) (subscription required); Kaja Whitehouse, *Bitcoin is Surging. Here's One Reason Why*, U.S.A. TODAY (Nov. 5, 2015), <http://www.usatoday.com/story/money/2015/11/05/wall-street-betting-further-bitcoin-gains/75221568/>. The Economist even dedicated a cover the subject. See ECONOMIST, *The Trust Machine: The Technology Behind Bitcoin Could Transform How the Economy Works* (Oct. 31, 2015).

<sup>2</sup> See e.g., David Yermack, *Is Bitcoin a Real Currency? An Economic Appraisal*, National Bureau of Economic Research Working Paper No. 19747 (Dec. 2013), <http://www.nber.org/papers/w19747> (subscription required); Rainer Böhm, Nicolas Christin, Benjamin G. Edelman, Tyler Moore, *Bitcoin: Economics, Technology, and Governance*, 29 J. ECON. PERSP. 213 (Spring 2015).

<sup>3</sup> See e.g., Judith Lee, Arthur Long, Marcellus McRae, Jeff Steiner, Stephanie Gosnell Handler, *Bitcoin Basics: A Primer on Virtual Currencies*, 16 NO. 1 BUS. L. INT'L. 21 (Jan. 2015); Brad Jacobsen & Fred Peña, *What Every Lawyer Should Know About Bitcoins*, Aug. 27 UTAH BUS. J. 40 (July/Aug. 2014); Nat Wasserstein, *Bitcoin Laws and Regulations in the United States: The Use of Bitcoin by Attorneys*, 40 WESTCHESTER BAR J. 59 (Wint./Spring 2015).

<sup>4</sup> See e.g., GOVERNMENT ACCOUNTABILITY OFF., *Virtual Currencies: Emerging Regulatory, Law Enforcements, and Consumer Protection Challenges*, GAO 14-496 (May 2014), <http://www.gao.gov/assets/670/663678.pdf>; Eur. Cent. Bank, *Virtual Currency Schemes* (Oct. 2012), <http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf>; Eur. Sec. & Mkt. Auth., *Call for Evidence: Investment Using Virtual Currency or Distributed Ledger Technology*, ESMA/2015/532 (Apr. 2015), [https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-532\\_call\\_for\\_evidence\\_on\\_virtual\\_currency\\_investment.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-532_call_for_evidence_on_virtual_currency_investment.pdf).

<sup>5</sup> See e.g., BANK FOR INT'L SETTLEMENTS, COMM. ON PAYMENTS AND MARKET INFRASTRUCTURES, DIGITAL CURRENCIES (Nov. 2015), <http://www.bis.org/cpmi/publ/d137.pdf>; Dong He et al., *IMF Staff Discussion Note: Virtual Currencies and Beyond: Initial Considerations*, INTERNATIONAL MONETARY FUND (Jan. 2016), <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf>.

<sup>6</sup> See e.g., Jeff Clark, *Bitcoin: Decentralized Virtual Currency*, The Data Center Journal (Mar. 5, 2013), <http://www.datacenterjournal.com/bitcoin-decentralized-virtual-currency/>; James Surowiecki, *Cryptocurrency*, MIT Technology Review (Aug. 23, 2011), <https://www.technologyreview.com/s/425142/cryptocurrency>.

<sup>7</sup> See Government Accountability Office, *Virtual Currencies: Emerging Regulatory, Law Enforcements, and Consumer Protection Challenges*, GAO 14-496, 4 (May 2014), <http://www.gao.gov/assets/670/663678.pdf>.

<sup>8</sup> *Id.* at 5, 7.

<sup>9</sup> Andreas M. Antonopolous, *Mastering Bitcoin: Unlocking Digital Cryptocurrencies*, Chapter 4 under heading “Pay-to-Script Hash (P2SH) and Multi-Sig Addresses” (O’Reilly Media 2014). “Smart contracts” are conceptually established enough that there has already been a Securities and Exchange Commission enforcement action related to a fraudulent scheme involving them. *See In re Sand Hill Exchange, Gerrit Hall, and Elaine Ou*, SEC Release 33-9809 (June 17, 2015).

<sup>10</sup> Andrew Hinkes, *Blockchains, Smart Contracts, and the Death of Specific Performance*, INSIDE COUNSEL (July 29, 2014), <http://www.insidecounsel.com/2014/07/29/blockchains-smart-contracts-and-the-death-of-specific-performance>?sreturn=1456677888.

<sup>11</sup> *See* Trevor I. Kiviat, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 DUKE L.J., Dec. 2015, 569, 577-80. A crypto-ledger is inherent in the original design of Bitcoin: “We have proposed a system for electronic transactions without relying on trust. We started with the usual framework of coins made from digital signatures, which provides strong control of ownership, but is incomplete without a way to prevent double-spending. To solve this, we proposed a peer-to-peer network using proof-of-work to record a public history of transactions that quickly becomes computationally impractical for an attacker to change. . . .” Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN.ORG, <https://bitcoin.org/bitcoin.pdf>.

<sup>12</sup> *See e.g.*, Meghan E. Griffiths, *Virtual Currency Businesses: An Analysis of the Evolving Regulatory Landscape*, 16 TEX. TECH. ADMIN. L.J. 303, 306-08 (2015); Ethan D. Jeans, *Funny Money or the Fall of Fiat: Bitcoin and Forward-Facing Virtual Currency Regulation*, 13 COLO. TECH. L.J. 99, 102-09 (2015); Dustin M. Monroy, *Bitcoin and Banks – A Primer*, HAW. B.J. 14 *passim* (2015).

<sup>13</sup> Houman B. Shadab, *Regulating Bitcoin and Block Chain Derivatives* at 2, Written Statement to the CFTC Global Markets Advisory Committee (Oct. 9, 2014), [http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac\\_100914\\_bitcoin.pdf](http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_100914_bitcoin.pdf).

<sup>14</sup> *In re Coinflip, Inc.*, CFTC No. 15-29, n.2 <http://www.cftc.gov/idc/groups/public/@enforcementactions/documents/legalpleading/enfcoinfliporder09172015.pdf> (Sept. 17, 2015); “Bitcoin and other virtual currencies are distinct from ‘real’ currencies, which are the coin and paper money of the United States or another country that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance.” *Id.*

<sup>15</sup> *See* Olivia Solon, *The Bitcoin Community Disagrees on What Happens Next*, BLOOMBERG BUSINESS (Sept. 18, 2015, 12:00 PM), <http://www.bloomberg.com/news/articles/2015-09-18/the-bitcoin-community-disagrees-on-what-happens-next>; Abe Cofnas, *Bitcoin: Currency or Commodity?*, FUTURES (June 1, 2014), <http://www.futuresmag.com/2014/05/31/bitcoin-currency-or-commodity?page=1>; Isaac M. Marcushamer & Andrew M. Hinkes, *Bitcoin In Bankruptcy: Is It Commodity Or Currency?*, LAW360 (Feb. 18, 2016, 10:26 AM), <http://www.law360.com/technology/articles/760393/bitcoin-in-bankruptcy-is-it-commodity-or-currency>. Although securities law is outside of the scope hereof, a virtual currency scheme meeting the “investment contract” tests in *SEC v. W.J. Howey & Co.*, 328 U.S. 293, 298-99 (1946) would be a security subject to Securities and Exchange Commission regulation. *See SEC v. Shavers*, 2013 WL 4028182, at \*2 (E.D. Tex. Aug. 6, 2013).

<sup>16</sup> The only exclusions are onions and motion picture box office receipts. Commodity Exchange Act § 1a(9). Futures trade in either is illegal. 7 U.S.C. § 13–1. For the history behind the onion exclusion, *see* Keith Romer, *The Great Onion Corner and the Futures Market*, NATIONAL PUBLIC RADIO (Oct. 23, 2015), <http://www.npr.org/2015/10/22/450769853/the-great-onion-corner-and-the-futures-market>. The exclusion of and prohibition of futures trading in motion picture box office receipts were added by sections 721(a) and 721(e)(10) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Pub. L. No. 111-203 (2010).

<sup>17</sup> *See* Commodity Exchange Act §§ 2(a), (c), (d), and (f)-(i). Major exclusions of CFTC exist, for example, with respect to securities. Commodity Exchange Act §§ 2(a)(1)(D) & 2(c)(1). For the limitations on CFTC jurisdiction over foreign exchange transactions as compared to transactions involving commodities more generally, *see* the table *infra*.

<sup>18</sup> *See, e.g., The Legal Tender Cases*, *Julliard v. Greenman* 110 U.S. 421, 449, 450 (1884).

<sup>19</sup> Commodity Exchange Act §§ 1a(24) & (25).



<sup>20</sup> See Press Release, CFTC Orders Bitcoin Options Trading Platform Operator and its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps without Registering, CFTC Press Release PR7231-15 (Sept. 17, 2015), <http://www.cftc.gov/PressRoom/PressReleases/pr7231-15>.

<sup>21</sup> *In re Coinflip, Inc.*, CFTC No. 15-29, n.2 <http://www.cftc.gov/idx/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliporder09172015.pdf> (Sept. 17, 2015); See also *CFTC Orders Bitcoin Options Trading Platform Operator and its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps without Registering*, CFTC Press Release pr7231-15, <http://www.cftc.gov/PressRoom/PressReleases/pr7231-15> where it is noted in the subtitle that “In First Action against an Unregistered Bitcoin Options Trading Platform, CFTC Holds that Bitcoin and Other Virtual Currencies Are a Commodity Covered by the Commodity Exchange Act.” See *infra* note 37. In addition the CFTC has issued an order related to an enforcement action against a provisionally-registered swap execution facility for a failure to enforce prohibitions on wash trades occurring on its facility and in relation to a non-U.S. trading platform trading contracts treated for regulator purposes as futures contracts for illegally trading commodity futures of exchange and failing to register as futures commissions. See *In re TeraExchange LLC*, CFTC Docket No. 15-33 (Sept. 24, 2015), <http://www.cftc.gov/idx/groups/public/@lrenforcementactions/documents/legalpleading/enfteraexchangeorder92415.pdf>. See also *In re BFXNA INC. d/b/a Bitfinex*, CFTC Docket No. 16-19 (June 2, 2016), <http://www.cftc.gov/idx/groups/public/@lrenforcementactions/documents/legalpleading/enbfxnaorder060216.pdf>.

<sup>22</sup> *In re Coinflip, Inc.*, CFTC No. 15-29, n.2 <http://www.cftc.gov/idx/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliporder09172015.pdf> (Sept. 17, 2015).

<sup>23</sup> See 17 C.F.R. § 32.3(a)(3).

<sup>24</sup> Since, technically, “currency” is a subset of “commodity,” the term “commodity” refers herein to a commodity other than currency unless the context requires otherwise.

<sup>25</sup> 31 U.S.C. § 1010.100(m); See also Financial Crimes Enforcement Network, *Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (Mar. 18, 2013), [https://www.fincen.gov/statutes\\_regs/guidance/html/FIN-2013-G001.html](https://www.fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html).

<sup>26</sup> I.R.S. Notice 2014-21, 2014-16 I.R.B. 938.

<sup>27</sup> *Currency*, BLACK’S LAW DICTIONARY (10th ed. 2014).

<sup>28</sup> The key difference for the economist is that, while money can be any financially liquid medium of exchange, store of value, and unit of account, currency is considered to be more specifically coins and notes available for immediate spending (or, in the view of some regulators must be legal tender). See discussion *supra* note 21. See IRVIN B. TUCKER, *SURVEY OF ECONOMICS* 393-97 (South-Western, Cengage Learning 8th ed. 2012). The Federal Reserve’s definitions of “M1,” largely corresponding to currency in particular, and “M2,” largely corresponding to the broader category of money). See also Federal Reserve Board, *What is the money supply? Is it important?*, (Dec. 16, 2015), [https://www.federalreserve.gov/faqs/money\\_12845.htm](https://www.federalreserve.gov/faqs/money_12845.htm).

<sup>29</sup> *Money*, MERRIAM-WEBSTER ONLINE <http://www.merriam-webster.com/dictionary/money>.

<sup>30</sup> *U.S. v. Faiella*, 39 F. Supp. 3d 544, 545 (S.D.N.Y. 2014).

<sup>31</sup> *SEC v. Shavers*, 2013 WL 4028182, at \*2 (E.D. Tex. Aug. 6, 2013).

<sup>32</sup> Whether such an option can be utilized with respect to virtual currency is an open question since one requirement is that the offeree be a “producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or by-products thereof.” 17 C.F.R. § 32.3(a). This could potentially limit the utility of the trade option exception to physical commodities. See also note 40 *infra*.

<sup>33</sup> See the table immediately below for a more detailed description and comparison of the CFTC’s jurisdiction over foreign exchange transactions and commodity transactions in general.

<sup>34</sup> The CFTC has jurisdiction over foreign exchange futures transactions traded on an exchange. See Commodity Exchange Act § 2(c)(2)(A)(i). All commodity futures are required to be traded on a futures exchange. See Commodity Exchange Act § 6(a). As noted in “Legal Treatment by the CFTC: Commodities” the definition of commodity is very broad and includes currency. See discussion *supra* SECTION NUMBER.

<sup>35</sup> See Commodity Exchange Act §§ 2(a)(1)(A) & 4(a).

<sup>36</sup> Commodity Exchange Act § 2(c)(2)(A)(iii).

<sup>37</sup> Commodity Exchange Act § 2(c)(2)(A)(i).

<sup>38</sup> 17 C.F.R. 1.3(y)(3)(v)(B). *See also* with respect to distinct treatment of foreign exchange options from foreign exchange forwards (as noted *infra*, foreign exchange forwards are exempt from many regulatory requirements applicable to foreign exchange options, *Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act*, 77 Fed. Reg. 69694, 69695 (Nov. 20, 2012); “Foreign exchange options, currency swaps, and [non-deliverable forwards] (as discussed below) may not be exempted from the [Commodity Exchange Act’s] definition of ‘swap’ because they do not satisfy the statutory definitions of a foreign exchange swap or forward.” *Id.*

<sup>39</sup> Commodity Exchange Act § 1a(18) & 17 C.F.R. §1.3(m).

<sup>40</sup> Commodity Exchange Act § 2(c)(2)(B). For the exception for entities regulated by “Federal regulatory agency,” *see* Commodity Exchange Act § 2(c)(2)(E)(i). There is a requirement that the regulators of such entities enact enabling rules. Commodity Exchange Act § 2(c)(2)(E)(ii)(1). This has been the case with the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve Board. *See Retail Foreign Exchange Transactions*, 78 Fed. Reg. 42439-01 (July 16, 2013); *Retail Foreign Exchange Transactions*, 76 Fed. Reg. 40779 (July 12, 2011); *Retail Foreign Exchange Transactions*, 76 Fed. Reg. 41375 (July 14, 2011); and *Retail Foreign Exchange Transactions (Regulation NN)*, 78 Fed. Reg. 21019 (Apr. 8, 2013).

<sup>41</sup> The trade option exemption requires that the offeree be a “producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or by-products thereof, and such offeree is offered or entering into the commodity option transaction solely for purposes related to its business as such” and that the offeror either meet the preceding criteria or be an eligible contract participant. 17 C.F.R. § 32.3(a). Additionally, the offeror must have a “reasonable basis to believe” that the offeree meets the trade option criteria (*Id.*) and there must be an intent to physically deliver the commodity underlying the option. 17 C.F.R. § 32.3(a)(3). Trade options are generally exempt “from the rules otherwise applicable to other swaps (i.e., the Dodd-Frank swaps regime).” *See Commodity Options*, 77 FR 25320, 25326 (Apr. 27, 2012).

<sup>42</sup> Foreign Exchange Forward is defined in Commodity Exchange Act § 1a(24) as “a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.” There is no definition of a commodity forward within the Commodity Exchange Act or CFTC regulations. However, Commodity Exchange Act §1a(27) excludes from what is deemed “future delivery” any “sale of any cash commodity for deferred shipment or delivery.” This is commonly known as the “forward exception” for commodities and may differ from the industry definition of forward.

<sup>43</sup> Commodity Exchange Act § 1a(47)(E) & 17 C.F.R. 1.3(xxx)(3). The foregoing provides an exemption for foreign exchange forwards from most of the regulatory requirements contingent upon the Secretary of the Treasury making a determination of exemption. The Secretary of the Treasury did so in 2012. *See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act*, 77 Fed. Reg. 69694 (Nov. 20, 2012).

<sup>44</sup> 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa) (2012). There are other exceptions, including one if there is “an enforceable obligation to deliver between a seller and a buyer that have the ability to deliver and accept delivery, respectively, in connection with the line of business of the seller and buyer.” 7 U.S.C. § 2(c)(2)(D)(ii)(III)(bb).

<sup>45</sup> “Retail” for these purposes is a person that is not an “eligible contract entity” or “eligible commercial participant.” 7 U.S.C. § 2(c)(2)(D)(i)(I)-(II) (2012). The definitions of “eligible commercial entity” and “eligible commercial participant” can be found in 7 U.S.C. § 1a (17), (18).

<sup>46</sup> 7 U.S.C. § 2(c)(2)(D)(ii).

<sup>47</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Pub. L. No. 111-203 (2010) granted the CFTC new authority in Commodity Exchange Act § 6(c)(1) by making it “unlawful for any person, directly or indirectly, to use or employ or attempt to use or employ, in connection with . . . a contract of sale of any commodity in interstate commerce . . . any manipulative or deceptive device or contrivance. . . .” In 2011, the CFTC promulgated a rule making it unlawful with respect to, among others, a contract of sale of any commodity in interstate commerce, to “intentionally or recklessly: (1) use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud; (2) make, or attempt to

make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading; (3) engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; or, (4) deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.” Note that this is a significant difference from spot foreign exchange since the CFTC is excluded from having jurisdiction on this basis over spot foreign exchange. See Commodity Exchange Act §§ 2(c)(2)(B)(iii) & 2(c)(2)(C)(ii)(I).

<sup>48</sup> See *inter alia* Commodity Exchange Act §§ 1a(47), 2(d), 2(e), 2(h); See generally 17 C.F.R. § 1.3.

<sup>49</sup> 7 U.S.C. § 1a(47)(E) (2012); 17 C.F.R. 1.3(xxx)(3); see *supra* note 42.

<sup>50</sup> See *inter alia* Commodity Exchange Act §§ 1a(47), 2(d), 2(e), 2(h), and 17 C.F.R. § 1.3(xxx).

<sup>51</sup> Commodity Exchange Act § 2(c)(2)(C)(i)(I)(aa). Retail for these purposes is a person that is not an eligible contract participant. *Id.* For the entities deemed to be regulated by a Federal regulatory agency, see *supra* note 39. Retail for these purposes is a person that is not an “eligible contract participant” or “eligible commercial entity.” Commodity Exchange Act.

<sup>52</sup> Commodity Exchange Act § 2(c)(2)(C)(i)(I)(bb).

<sup>53</sup> Commodity Exchange Act § 2(c)(2)(C)(i)(II)(bb)(AA). There are other exceptions, including one if there is “an enforceable obligation to deliver between a seller and a buyer that have the ability to deliver and accept delivery, respectively, in connection with their line of business.” Commodity Exchange Act §§ 2(c)(2)(C)(i)(II) & 2(c)(2)(C)(i)(II)(bb)(BB).

<sup>54</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) (Pub. L. No. 111-203 (2010)) granted the CFTC new authority in Commodity Exchange Act § 6(c)(1) by making it “unlawful for any person, directly or indirectly, to use or employ or attempt to use or employ, in connection with . . . a contract of sale of any commodity in interstate commerce . . . any manipulative or deceptive device or contrivance. . . .” In 2011, the CFTC promulgated a rule making it unlawful with respect to, among others, a contract of sale of any commodity in interstate commerce, to “intentionally or recklessly: (1) use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud; (2) make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading; (3) engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; or, (4) deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.” Note that this is a significant difference from spot foreign exchange since the CFTC is excluded from having jurisdiction on this basis over spot foreign exchange. See Commodity Exchange Act §§ 2(c)(2)(B)(iii) & 2(c)(2)(C)(ii)(I).

<sup>55</sup> See discussion *supra* Section “What is the Impact of the CFTC’s Determination That Virtual Currency is a Commodity?”

<sup>56</sup> *In re Coinflip, Inc.*, CFTC No. 15-29, n.2 <http://www.cftc.gov/ido/groups/public/@enforcementactions/documents/legalpleading/enfcoinfliporder09172015.pdf> (Sept. 17, 2015).