

## ContractsProf Blog

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### **GLOBAL K: Bitcoins – Actually a Virtual Problem**

By Michael P. Malloy

Over the past year, there has been an explosion of interest – and a frenzied up-swing in trading – in bitcoins. Writing in *The New York Times* in late December 2013, in an article called *Into the Bitcoin Mines*, Nathaniel Popper noted that “The scarcity — along with a speculative mania that has grown up around digital money — has made each new Bitcoin worth as much as \$1,100 in recent weeks.” From a socio-economic perspective, this offers an unusual opportunity to observe the emergence and development of an entirely new, and so far unregulated, kind of market. Scholars like Wallace C. Turbeville interested in the law and policy of financial services regulation are now presented with an important opportunity to test assumptions we often blithely make about the ways in which regulation interacts with business and commercial activity.

Policymakers may confront a moment of truth – to regulate or not to regulate, and when, and how. Earlier this month, National Taxpayer Advocate Nina Olson argued that the IRS should give taxpayers clear rules on how it will handle transactions involving bitcoin and other digital currencies accepted as payment by vendors. The Senate Homeland Security and Governmental Affairs Committee held hearings on bitcoins and other “cryptocurrencies” several weeks ago, and may have a report on the situation early next year after further consideration, but Committee Chair Sen. Thomas Carper (D-Del.) seems to be taking a “wait and see” attitude. Meanwhile, the People’s Republic of China has already banned banks from using bitcoins as a currency, while U.S. regulators have not addressed the use of virtual currencies, even as an increasing number of vendors – including Overstock.com – have announced that they will accept them in payment for transactions.

One basic problem is the difficulty in determining what is involved in bitcoin creation and trading. Unfortunately, we are as yet at the mercy of metaphors. For example, within the first six paragraphs of his *NYT* piece, Popper refers to bitcoins as “virtual currency,” “invisible money,” “a speculative investment,” “online currency,” and “a largely speculative commodity.” In point of fact, bitcoins are book-entry tokens awarded for successfully solving highly complex algorithms generated by an open-source program. The program is disseminated by a mysterious, anonymous sponsor or group known only as Satoshi Nakamoto – the digital world’s version of Keyser Söze.

Determination of the proper legal characterization of bitcoins is essential if we are to choose appropriate transactional and regulatory approaches. For example, if bitcoins really are a “virtual currency” – a meaningless phrase, a glib metaphor – then fiscal supervision by the Federal Reserve might be the most appropriate approach to regulating bitcoin activity. Further, if they are in any significant sense “currency,” then treatment under the U.S. securities regulation framework would be problematic, since “currency” is excluded from the statutory definition of “security” in section 3(a)(10) of the Securities Exchange Act. Similarly, if bitcoins are viewed as some sort of currency, they would then likely be an “excluded commodity” under section 1a(19)(i) of the Commodity Exchange Act. On the other hand, if bitcoins are viewed as derivatives of currency or futures contracts in currency, then they may be subject to securities regulation, or possibly commodities regulation, depending upon the basic characteristics and rights of the financial product itself. The exact delimitation between treatment as a security and treatment as a commodity is currently the

subject of study and proposed rulemakings by the SEC and the CFTC.

Recent news reports have noted that bitcoins are beginning to be accepted by more and more vendors as a form of payment. If in fact it becomes a commonplace that bitcoins operate as a payment mechanism, then we must deal with the possibility that they should be subject to transactional rules of the UCC and the procedures of payment clearance centers. It is at this point that the contractual aspects of bitcoins become critical features of our analysis.

Conceivably, we might go further and argue that bitcoins are functionally a type of note – relatively short-term promises to pay the holder – in which case, they would be subject to UCC article 3, exempt or excluded from securities registration requirements, but *possibly* still subject to securities antifraud rules. This is an attractive alternative, since it would give us some definite transactional rules to work with, plus antifraud protection against market manipulation – if we could figure out what “manipulation” should mean in the strange new world of cryptocurrencies.

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[http://lawprofessors.typepad.com/contractsprof\\_blog/2014/01/global-k-bitcoins-actually-a-virtual-problem.html](http://lawprofessors.typepad.com/contractsprof_blog/2014/01/global-k-bitcoins-actually-a-virtual-problem.html)

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