

NEW YORK ATTORNEY GENERAL WARNS VIRTUAL CURRENCY INDUSTRY MEMBERS TO REGISTER UNDER THE MARTIN ACT – DO BITLICENSE HOLDERS NEED TO DUAL-REGISTER?

On March 1, 2021, the Office of New York Attorney General Letitia James (the "NYAG") published an "Industry Alert" reminding the virtual currency industry that individuals and entities dealing in virtual or cryptocurrencies that are considered commodities or securities in the state of New York must register with the NYAG.¹ The Industry Alert comes on the heels of the NYAG's lawsuit against Coinseed, Inc., and two of its executives, filed in February,² alleging that Coinseed – which offered a mobile application that functioned as a trading platform and allowed customers to trade virtual currencies – was required to register with the NYAG as a commodity broker-dealer under the Martin Act,³ among other violations.

This is the first time the NYAG has brought an action against a virtual currency company for failing to register as a commodity broker-dealer under the Martin Act. What makes these developments particularly noteworthy is that neither the NYAG's Industry Alert nor the NYAG's Coinseed lawsuit addresses, or even references, the existing New York framework for regulating virtual currency business activities under the so-called Bitlicense regime⁴ administered by the New York Department of Financial Services ("NYDFS"). Coinseed, while based in New York, never obtained a Bitlicense, but that is not a basis for NYAG's action. In fact, the NYAG's decision to bring an action against Coinseed under the Martin Act and to publish the Industry Alert encouraging market participants to register with the NYAG under the Martin Act, does not address whether holders of Bitlicenses issued by NYDFS are exempt.

¹ <https://ag.ny.gov/sites/default/files/crypto-industry-notice.pdf>

² Complaint, *People of the State of New York v. Coinseed, Inc., et al.*, Case No. 0450366/2021, 2021 WL 678694 (Sup. Ct. N.Y. Cty. Feb. 17, 2021).

³ N.Y. Gen. Bus. L. Ch. 20, Art. 23-A.

⁴ 23 NYCRR Part 200

These developments raise questions for virtual currency industry members, including some existing Bitlicense holders.

There is no express exemption for holders of Bitlicenses (or conditional Bitlicenses) issued by NYDFS from the Martin Act's commodity broker-dealer, commodity salesperson, and commodity investment advisor ("commodity intermediary") registration requirement with the NYAG. Unless guidance from the NYAG and NYDFS is released that establishes a safe harbor, virtual currency industry members face the risk that they will need to concurrently register with both regulators, unless they can rely on another exemption, such as the enumerated exemptions for licensed money transmitters or trust companies.⁵ Bitlicense holders who are not also licensed as money transmitters, and unlicensed virtual currency companies generally, who operate in New York should be aware that multiple New York regulators have jurisdiction over their activities, creating multiple sources of potential liability for failing to register (and related claims), and that failure to register with the NYAG as a commodity intermediary under the Martin Act, if required, can result in criminal charges.

The Coinseed Lawsuit

Coinseed, from its principal place of business in New York City, operates a virtual currency trading platform through a mobile application ("app") available for download through the Apple App Store and Google Play. Coinseed's mobile app allows users to link their credit or debit cards to their Coinseed account. When their everyday purchases reach a prescribed threshold, Coinseed debits the user's bank account. Coinseed first transfers the user's cash to its own bank account, then deposits it with another virtual currency trading platform where Coinseed holds an institutional trading account. This allows the user to purchase virtual currency through Coinseed. Users have the option to invest in one virtual currency or split their investments among multiple virtual currencies, with the selected virtual currencies forming the user's "portfolio". Users can make virtual currency allocations by reviewing Coinseed's algorithmic ranking of all of the investor portfolios on Coinseed's mobile app, which is purportedly based on the profitability generated by each investor's trading account. Coinseed also maintains a ledger of all trades made by users and internally matches trades when possible.

The NYAG complaint alleges that virtual currencies are commodities and that, by conducting these activities, Coinseed operated as a commodity broker-dealer through its mobile app without registering with the NYAG as is required by the Martin Act.⁶ The NYAG's complaint does not contain an alleged violation for failure to register with, and obtain a Bitlicense from, NYDFS, despite the fact that Coinseed's activities appear to be within the scope of the definition of a "Virtual Currency Business Activity" under the NYDFS' Bitlicense regulation.⁷ In addition,

⁵ Licensed money transmitters, trust companies, banks, and persons registered or exempt from registration under the U.S. Commodity Exchange Act, among others are exempt from The Martin Act's commodity intermediary registration requirements. See N.Y. Gen. Bus. L. § 359-e(14)(g). Virtual currency companies operating in New York that have either been granted trust charters by NYDFS (with authorization to engage in virtual currency business activity) or have received both a Bitlicense and a money transmitter license, should not be affected by these developments.

⁶ The NYAG also alleges that Coinseed's Initial Coin Offering ("ICO") to raise money to fund the mobile app's development was an unregistered securities offering in violation of New York law, and that Coinseed and its executives made misleading statements during the ICO. The US Securities and Exchange Commission has brought a parallel enforcement action alleging Coinseed's ICO was an unregistered securities offering under the federal securities laws.

⁷ See 23 NYCRR § 200.2(q).

while the NYAG noted that it cooperated with the SEC, there is no indication that the NYAG coordinated with NYDFS in investigating and bringing the action against Coinseed.⁸

The Industry Alert

Two weeks after filing the Coinseed lawsuit, the NYAG published the Industry Alert, reminding businesses that commodity broker-dealers,⁹ commodity salespersons,¹⁰ and commodity investment advisors¹¹ doing business within or from New York are required by the Martin Act to register with the NYAG.¹² The NYAG supports its position in the Industry Alert that virtual currencies are commodities subject to the registration provisions of the Martin Act by citing an Appellate Division, July 2020 decision holding that the Tether stablecoin is a commodity, even though the decision focused exclusively on the Tether stablecoin.¹³ The Industry Alert reminds industry members that failure to register with the NYAG under the Martin Act as a commodity intermediary could subject them to both civil and criminal liability. The Industry Alert does not mention the Bitlicense regulation administered by NYDFS or specify the circumstances under which a Bitlicense holder would also need to register with the NYAG to avoid violating the Martin Act.

Analysis and Takeaways

The NYAG's Coinseed enforcement action and its subsequent Industry Alert are reminders to virtual currency industry members that there are separate regulatory regimes in New York that apply to the virtual currency industry. NYDFS promulgated the Bitlicense regulations based on statutory authority under the New York Financial Services Law and Banking Law,¹⁴ not the Martin Act, which is enforced by the NYAG. Thus, absent further clarification and guidance, virtual currency industry members that are not registered with the NYAG face enforcement risks, unless an exemption is available.¹⁵

As it stands, virtual currency companies seeking to enter the New York market for the first time must consider their registration requirements under both the NYDFS and NYAG regimes. Bitlicense registration with NYDFS alone or licensing with the NYAG may not be enough standing on its own, and registration with both carries increased compliance costs. The fact that, under certain circumstances, failure to register with the NYAG as a commodity broker-dealer, commodity salesperson, or commodity investment advisor under the Martin Act constitutes a Class E felony¹⁶ raises the stakes for virtual currency companies doing business in New York.

⁸ See Press Release, Attorney General James Sues to Shut Down Illegal Cryptocurrency Trading Platform and Virtual Currency, Seeks to Recoup Defrauded Funds for Thousands of Investors, (Feb. 17, 2021), available online at <https://ag.ny.gov/press-release/2021/attorney-general-james-sues-shut-down-illegal-cryptocurrency-trading-platform-and>

⁹ N.Y. Gen. Bus. L. § 359-e(14)(a)(iii).

¹⁰ N.Y. Gen. Bus. L. § 359-e(14)(a)(iv).

¹¹ N.Y. Gen. Bus. L. § 359-e(14)(a)(v).

¹² N.Y. Gen. Bus. L. § 359-e(14)(b).

¹³ *James v. iFinex*, 185 A.D.3d 22, 28 (1st Dep't 2020).

¹⁴ Specifically, NYDFS' publication of the final Bitlicense regulation in the New York State Register cites the following statutory authority: "Financial Services Law, sections 102, 104, 201, 202, 206, 301, 302, 303, 304-a, 305, 306, 309, 404 and 408; Banking Law, sections 10, 14, 36, 37, 39, 40, 44, 44-a, 78, 128, 225-a, 600, 601-a and 601-b; and Executive Law, section 63". See NY Reg. June 24, 2015, at 7, available online at <https://docs.dos.ny.gov/info/register/2015/june24/pdf/rulemaking.pdf>

¹⁵ See *supra*, fn.5.

¹⁶ N.Y. Gen. Bus. L. § 359-e(14)(k).

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