

The Texas Lawbook

State Attorneys General Poised to Elevate Regulatory Scrutiny of Digital Asset Businesses

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The Attorney General Alliance recently issued a collaborative [White Paper](#) that signals heightened scrutiny of digital asset businesses by state attorneys general in coming years. Recognizing that it is “no longer acceptable to be on the sidelines” because blockchain technology and virtual assets are “here to stay,” the AGA issued its White Paper to inform state attorneys general about various cryptocurrency and blockchain issues. To this end, the White Paper provides an overview of the digital asset marketplace, summarizes the status and scope of state and federal regulation of digital asset businesses, highlights the important role of state attorneys general in investigating digital asset businesses and initiating enforcement actions, and spotlights recent noteworthy settlements.

The AGA signals that, in the absence of a comprehensive federal regulatory scheme, states will continue to enact laws that reach a range of digital asset activity and state attorneys general will expand and ramp up investigations and legal actions that seek injunctions, restitution and civil penalties from digital asset businesses.

In this article, we highlight the key takeaways from the AGA’s White Paper and identify important legal considerations for digital asset businesses to take notice of in this rapidly evolving regulatory environment.

Overview

In the White Paper, the AGA presses state attorneys general to “engage with th[e] new – and ever growing” digital asset industry, to “understand the technology” and to “appreciate how this new area of commerce impacts [its] constituents.” To help state attorneys general break down barriers to entry when encountering blockchain or cryptocurrency issues, the AGA outlines various types of coins, tokens and NFTs, explains how blockchain and wallet technologies work, and summarizes the basics around cryptocurrency mining and the operations of various platforms and exchanges. The AGA also surveys the landscape of current state and federal regulations and highlights with examples how digital assets have become the target of traditional cybercrimes like fraud, laundering and ransoms, as well as various scams, such as “rug pulls,” “pump and dumps” and “SIM-swapping.”

Importantly, the AGA also lays out the pivotal role that state attorneys general can play in the regulation of digital assets. Specifically, the AGA proposes that state attorneys general (1) collaborate in multijurisdictional investigations to avoid duplicative efforts, (2) share available resources and expertise with other state regulators, (3) investigate individual and one-off cases to fill the enforcement gap left by federal agencies that focus on national and global investigations, and (4) work with federal law enforcement agencies where appropriate.

Taking the lead: States are swiftly filling the regulatory gap left by the federal government

Despite a bevy of banking and finance laws and regulations, “Congress has never adopted a particular regulatory regime for digital assets and has passed few federal laws that expressly regulate activities related to digital assets.” As the AGA notes, existing federal laws, while extensive, were “developed long ago to solve very different problems from those that digital assets pose.” As a result, when it comes to addressing the emerging and still-evolving digital asset space, the federal legal landscape is neither clear nor comprehensive, thus leaving the SEC and CFTC to compete over jurisdiction, while other federal agencies (*e.g.* FinCEN, OFAC, OCC, CFPB and DOJ) have only recently jumped into the fray of digital asset regulation and enforcement.

Perhaps motivated by the lack of federal action, President Joe Biden issued an executive order in March 2022 that establishes key priority areas for digital assets and that requests policy recommendations from federal agencies as to potential regulatory and legislative actions to protect consumers, investors and businesses. Notwithstanding President Biden’s proposed “whole-of-government” approach, the AGA asserts that states must “play a significant role in the day-to-day” regulation of the digital asset industry. Indeed, shortly after President Biden’s March 2022 announcement, California followed suit in May 2022 with Executive Order N-9-22, which directs the Department of Financial Protection and Innovation to “engage in a public process to develop a comprehensive regulatory approach to crypto assets harmonized with the direction of federal regulations and guidance” and to exercise its authority under the California Consumer Financial Protection Law “to develop guidance and, as appropriate, regulatory clarity and supervision of private entities offering crypto asset-related financial products and services” in California. Although in step with its federal counterpart, California’s executive order signals that states will not wait idly for the federal government to take action.

Digital asset regulations vary widely by state

As laboratories of democracy, states frequently cultivate a wide range of regulatory approaches to emerging industries. This is particularly true with digital assets as states structure their regulatory schemes to jockey for economic opportunities, while balancing consumer protection with attracting innovative technology firms and luring primed investors and financial institutions. Indeed, as the AGA notes, regulatory “sandbox” programs in different states have already been enacted “to support innovation in the space while further studying cryptocurrencies and related blockchain technology innovations.”

Although the AGA proposes that states enact similar regulatory schemes, rather than deferring to the federal government, states have taken a wide variety of approaches to digital asset regulation. By way of examples, Nebraska and Wyoming permit state-chartered digital asset depository institutions, digital assets have been incorporated into the Uniform Commercial Code in Arkansas, Texas and Wyoming, and Montana and Wyoming have exempted utility tokens (that meet certain criteria) from state securities laws. Ohio and Washington have conditioned money transmitter licenses on third-party auditing of computer systems, and Rhode Island and Washington are requiring that virtual currency licensees make certain disclosures to consumers. Moreover, several states have enacted some form of licensing regime for money transmitters dealing in virtual currencies.

In addition, other money transmitter licensing statutes expressly apply to virtual currency transactions subject to certain exceptions (*e.g.* Louisiana, North Carolina and Rhode Island); some statutes are arguably broad enough as written to require licensure for money transmitters dealing in virtual currency (*e.g.* Delaware, Kansas, Mississippi, Missouri, Nebraska and New Jersey); and other statutes exempt “sandbox participant” transmitters of virtual currency from licensure requirements (*e.g.* Florida, West Virginia and Wyoming). Importantly, this summary of state licensing requirements is nonexhaustive and subject to statutory exceptions, advisory opinions and/or “no action” letters—perhaps most notably New York’s “BitLicense” regime, which has already prompted investigations leading to noteworthy settlements. To be sure, these examples merely scratch the surface of the current scope of state legislation. At least 37 states and Puerto Rico have digital asset legislation pending during the 2022 legislative session. While new legislation will eventually bring a new wave of investigations and enforcement actions, existing state laws are already spurring investigations and significant settlements.

State attorneys general are closely scrutinizing digital asset businesses

Digital asset businesses are already under the regulatory microscope of state attorneys general. To date, several state attorneys general investigations have led to significant settlements. In February 2021, for example, the New York attorney general reached a \$479 million settlement with GTV Media Group following an investigation into alleged unlawful selling of stocks and digital instruments promoted as cryptocurrencies without state registration. Similarly, in September 2021, the New York attorney general reached an \$18.5 million settlement with Bitfinex & Tether resulting from an investigation into alleged false statements about the backing of a stablecoin and allegedly improper monetary transfers, and a \$3 million settlement with Coinseed for allegedly defrauding investors.

As noted by the AGA, state attorneys general employ investigatory tools that are particularly effective in the digital asset space because a blockchain is a permanent record of transactions that “allows for a clear record of the flow of money,” which enables state regulators to “forever track back” transfers of value, overcome complex efforts to conceal illegal activity and even seize illicitly obtained cryptocurrencies.

In addition to investigations, state regulators are also issuing cease and desist orders to some digital asset businesses to halt the unregistered and/or fraudulent offer and sale of certain digital assets, including BitConnect and Celsius, as well as pursuing civil penalties and restitution under state securities laws and deceptive trade practices statutes, seeking to enjoin the sale and promotion of digital asset goods and services and, in some instances, initiating criminal prosecutions for the unlicensed sale of digital assets.

Given the rapidly evolving market for digital assets, investigations and enforcement actions are likely to multiply as states expand regulation and as state attorneys general develop experience and expertise in investigating cryptocurrency and blockchain issues.

Conclusion

There is no doubt that states are closely scrutinizing the digital asset industry. In the absence of comprehensive federal oversight, states are swiftly enacting a wide variety of laws that regulate an array of digital asset products and services. In this rapidly evolving legal environment, digital asset businesses should closely follow state legislative developments and regulatory guidance from state agencies. Moreover, digital asset businesses should also pay special attention to the elevated scrutiny by state attorneys general, and to the corresponding surge in investigations and noteworthy settlements, by reexamining their existing compliance programs, particularly with respect to state licensing, auditing and disclosure requirements.

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