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

The Attorney General Alliance (“AGA”)¹ recently issued a collaborative White Paper that signals heightened scrutiny of digital asset businesses by state Attorneys General in coming years.² Recognizing that it is “no longer acceptable to be on the sidelines” because blockchain technology and virtual assets are “here to stay,”³ 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.”⁴ To help state Attorneys General break down barriers to entry when encountering blockchain or cryptocurrency issues,⁵ 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.⁶ 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.”⁷

Importantly, the AGA also lays out the pivotal role that state Attorneys General can play in the regulation of digital assets.⁸ Specifically, the AGA proposes that state Attorneys General (1) collaborate in multi-jurisdictional 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.⁹

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.”¹⁰ As the AGA notes, existing federal laws, while extensive, were “developed long ago to solve very different problems from those that digital assets pose,”¹¹ a point that King & Spalding previously explored with respect to NFTs.¹² As a result, when it comes to addressing the emerging and still-evolving digital asset space,¹³ the federal legal landscape is neither clear nor comprehensive, thus leaving the SEC and CFTC to compete over jurisdiction,¹⁴ 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.¹⁵

Perhaps motivated by the lack of federal action, President 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.¹⁶ 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.¹⁷ Indeed, shortly after President Biden’s March 2022 announcement, California followed suit in May 2022 with Executive Order N-9-22,¹⁸ 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.¹⁹ 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,”²⁰ 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.”²¹

Although the AGA proposes that states enact similar regulatory schemes, rather than deferring to the federal government,²² 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 institutions²³, digital assets have been incorporated into the Uniform Commercial Code in Arkansas, Texas, and Wyoming²⁴, and Montana and Wyoming have exempted utility tokens (that meet certain criteria) from state securities laws.²⁵ Ohio and Washington have



conditioned money transmitter licenses on third-party auditing of computer systems²⁶, and Rhode Island and Washington are requiring that virtual currency licensees make certain disclosures to consumers.²⁷ Moreover, several states have enacted some form of licensing regime for money transmitters dealing in virtual currencies²⁸—perhaps most notably New York’s “BitLicense” regime,²⁹ 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.³⁰ 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.³¹ 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,³² and a \$3 million settlement with Coinseed for allegedly defrauding investors.³³

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.³⁴

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,³⁵ including BitConnect³⁶ and Celsius,³⁷ as well as pursuing civil penalties and restitution under state securities laws and deceptive trade practices statutes,³⁸ seeking to enjoin the sale and promotion of digital asset goods and services,³⁹ and, in some instances, initiating criminal prosecutions for the unlicensed sale of digital assets.⁴⁰

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 the corresponding surge in investigations and noteworthy settlements, by re-examining their existing compliance programs, particularly with respect to state licensing, auditing, and disclosure requirements.



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¹ The AGA is an alliance of state Attorneys General, federal, state, and foreign officials, and public and private sector partners that focus on addressing complex issues in law and policy. The AGA's network reaches 46 states and territories, and is built on a foundation of fostering collaboration between state Attorneys General offices. See *Our Mission*, Attorney General Alliance, available at <https://www.agalliance.org/about/>.

² *Digital Assets White Paper*, Attorney General Alliance (April 8, 2022), available at <https://files.constantcontact.com/48922045201/588b8eba-571d-4075-a708-69c6dda04cc5.pdf> (hereinafter "*White Paper*").

³ *Id.* at 1.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 2–7.

⁷ *Id.* at 7–9, 11–13, 19–29.

⁸ *Id.* at 9–11.

⁹ *Id.* at 9–10.

¹⁰ *Id.* at 14.

¹¹ *Id.* at 13.

¹² See *The Anti-Money Laundering Act and Crypto Collide: Non-Fungible Tokens*, King & Spalding Client Alert (May 18, 2021), available at https://www.kslaw.com/attachments/000/008/786/original/NFTs_and_Anti-Money_Laundering.pdf?1621357633; *Not Your Standard Orange Grove: Non-Fungible Tokens & Securities Laws*, King & Spalding Client Alert (June 16, 2021), available at https://www.kslaw.com/attachments/000/008/853/original/Not_Your_Standard_Orange_Grove_Non-Fungible_Tokens_Securities_Laws.pdf?1623864133.

¹³ See *FinCEN Requests Comments on Beneficial Ownership Reporting Requirement; FinCEN's Request For Information Moves U.S. Towards Modernization Of BSA/AML Regime*, King & Spalding Client Alert (Dec. 17, 2021), available at https://www.kslaw.com/attachments/000/009/330/original/FinCEN_Requests_Comments_and_Information_For_Beneficial_Ownership_Reporting_Requirement_and_Changes_To_BSAAML_Regime.pdf?1641312167.

¹⁴ *White Paper* at 14–15.

¹⁵ *Id.* at 16–17.

¹⁶ *Executive Order on Ensuring Responsible Development of Digital Assets*, The White House (Mar. 9, 2022), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>.

¹⁷ *White Paper* at 13.

¹⁸ See *Governor Newsom Signs Blockchain Executive Order to Spur Responsible Web3 Innovation, Grow Jobs, and Protect Consumers*, Office of Governor Gavin Newsom (May 4, 2022), available at <https://www.gov.ca.gov/2022/05/04/governor-newsom-signs-blockchain-executive-order-to-spur-responsible-web3-innovation-grow-jobs-and-protect-consumers/>.

¹⁹ See *Executive Order N-9-22*, Executive Department State of California, available at <https://www.gov.ca.gov/wp-content/uploads/2022/05/5.4.22-Blockchain-EO-N-9-22-signed.pdf>.

²⁰ *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

²¹ *White Paper* at 8–9 (citing A.R.S. §§ 41-5601–5612; Fla. Stat. §559.952(4)(a)(3)–(14); NRS §§ 657A.100–657A.620; W. Va. Code § 31A-8G-4(d), (e); Wyo. Stat. §§ 40-29-101–109; 021.0008.1 Wyo. Code R. §§ 1–8; Wyo. Stat. § 40-22-104(b)).

²² *White Paper* at 9–10.

²³ See Neb. Rev. Stat. Ann. § 8-2724(1)(d)(i); Wyo. Stat. Ann. §§ 13-12-101–13-12-126.

²⁴ See Ark. Code Ann. § 4-7-106(b); Tex. Bus. & Com. Code Ann. § 9.1071; Tex. Bus. & Com. Code Ann. §§ 12.001–004; Wyo. Stat. Ann. § 34-29-102.

²⁵ See Mont. Code Ann. § 30-10-105(23)(a); Wyo. Stat. Ann. § 34-29-106.

²⁶ See Ohio Rev. Code Ann. § 1315.03(A) (requiring that "[e]ach application for a money transmitter license shall be in the form prescribed by the superintendent of financial institutions); Application for a Money Transmitter License Ohio Money Transmitter Act, Ohio Revised Code Section 1315.03, Ohio Department of Commerce, available at https://com.ohio.gov/static/documents/fin_MTScheduleADisclosure.pdf ("If the applicant will engage in the transaction of virtual currency in the course of money transmission activities, provide a current third party security audit of all relevant computer and information systems."); see also Wash. Rev. Code Ann. § 19.230.040(5) (requiring applicants of "business models that store virtual currency on behalf of others" to "provide a third-party security audit of all electronic information and data systems acceptable to the director"); Wash. Admin. Code 208-690-030(7) (requiring for licensure "an information security audit report" "[i]f you are engaged in virtual currency storage").



²⁷ See R.I. Gen. Laws § 19-14.3-3.5(b) (requiring disclosures related to, among other things, fees, insurance or guarantee by agency of the United States, irrevocability of transfer, a description of liabilities and responsibilities for transfer, notice that date and times of a transfer being debited may differ from when a transfer is initiated, rights to stop pre-authorized payment or revoke authorization for transfer, and that “virtual currency is not legal tender”); Wash. Rev. Code §§ 19.230.370(2)–(4) (requiring “clear and conspicuous” disclosures related to, among other things, fees, insurance or guarantees by agency of the United States, irrevocability of transfer, a description of liabilities and responsibilities for transfers, and “any additional disclosures the director may require as set forth in rule”); Wash. Admin. Code § 208-690-205(2) (requiring disclosures for all transactions that fraudulent transactions may result in loss of money without recourse, and for virtual currency transactions “clear and conspicuous” disclosures similar to Wash. Rev. Code §§ 19.230.370(2)–(4) as well as a pre-transaction disclosure that “the nature of virtual currency may lead to an increased risk of fraud or cyber attack” and that the “virtual currency value may be irretrievably stolen”).

²⁸ As of this writing, the following states expressly require money transmitters dealing in virtual currency to obtain licensure: Alabama, Alaska, Colorado, Connecticut, District of Columbia, Georgia, New York, and Vermont.

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 non-exhaustive and subject to statutory exceptions, advisory opinions, and/or “no action” letters.

²⁹ See N.Y. Comp. Codes R. & Regs. tit. 23, § 200.3(a) (“No Person shall, without a license obtained from the superintendent as provided in this Part, engage in any Virtual Currency Business Activity.”); N.Y. Comp. Codes R. & Regs. tit. 23, §§ 200.1–200.22; *Virtual Current Businesses*, New York State, Department of Financial Services, available at https://www.dfs.ny.gov/virtual_currency_businesses.

³⁰ *Cryptocurrency 2022 Legislation*, National Conference of State Legislatures (Mar. 17, 2022), available at <https://www.ncsl.org/research/financial-services-and-commerce/cryptocurrency-2022-legislation.aspx>.

³¹ *White Paper* at 10–11; see also *Attorney General James Ends Virtual Currency Trading Platform Bitfinex’s Illegal Activities in New York*, New York Attorney General (Feb. 23, 2021), available at <https://ag.ny.gov/press-release/2021/attorney-general-james-ends-virtual-currency-trading-platform-bitfinexs-illegal>.

³² *White Paper* at 11; see also *Attorney General James Secures Nearly Half a Billion Dollars to Resolve Illegal Stock and Cryptocurrency Sales*, New York Attorney General (Sept. 13, 2021), available at <https://ag.ny.gov/press-release/2021/attorney-general-james-secures-nearly-half-billion-dollars-resolve-illegal-stock>.

³³ *White Paper* at 11; see also *Attorney General James Shuts Down Virtual Currency Trading Platform and Stops Cryptocurrency CEO From Continuing Fraudulent Conduct*, New York Attorney General (Sept. 13, 2021), available at <https://ag.ny.gov/press-release/2021/attorney-general-james-shuts-down-virtual-currency-trading-platform-and-stops>.

³⁴ *White Paper* at 9–12.

³⁵ See, e.g., *Attorney General James Directs Unregistered Crypto Lending Platforms to Cease Operations In New York, Announces Additional Investigations*, New York Attorney General (Oct. 18, 2021), available at <https://ag.ny.gov/press-release/2021/attorney-general-james-directs-unregistered-crypto-lending-platforms-cease>; see also *New Jersey Bureau of Securities Orders Cryptocurrency Firm Celsius to Halt the Offer and Sale of Unregistered Interest-Bearing Investments*, New Jersey Office of the Attorney General (Sept. 17, 2021), available at <https://www.njoag.gov/new-jersey-bureau-of-securities-orders-cryptocurrency-firm-celsius-to-halt-the-offer-and-sale-of-unregistered-interest-bearing-investments/>.

³⁶ See *\$4 Billion Crypto-Promoter Ordered to Halt Fraudulent Sales*, Texas State Securities Commission (Jan. 4, 2018), available at <https://www.ssb.texas.gov/news-publications/4-billion-crypto-promoter-ordered-halt-fraudulent-sales>.

³⁷ See Order to Show Cause Why the Alabama Securities Commission Should Not Order Respondents to Cease and Desist From Further Offers or Sales of Securities in this State, *In the Matter of Celsius Network, LLC*, Administrative Order SC-2021-0012 (Ala. Sec. Comm. Sept. 16, 2021), available at <https://asc.alabama.gov/Orders/2021/SC-2021-0012.pdf>; Summary Cease and Desist Order, *In the Matter of Celsius Network, LLC* (N.J. Bureau of Securities Sept. 17, 2021), available at <https://www.nj.gov/oag/newsreleases21/Celsius-Order-9.17.21.pdf>; Emergency Order to Cease and Desist, *Dept. of Fin. Institutions v. Celsius Network LLC* (Ky. Dep’t. Fin. Institutions Sept. 23, 2021), available at <https://kfi.ky.gov/Documents/Celsius%20Network%20LLC%202021AH00024.pdf>;

see also *Before the State Office of Administrative Hearings, Texas State Securities Board v. Celsius Network, Inc., et al.*, SOAH Dkt. No. 312-22-0160 (Texas State Securities Board Sept. 17, 2021), available at https://www.ssb.texas.gov/sites/default/files/2021-09/20210917_FINAL_Celsius_NOH_js_signed.pdf.

³⁸ See *Attorney General James Sues to Shut Down Illegal Cryptocurrency Trading Platform and Virtual Currency, Seeks to Recoup Defrauded Funds for Thousands of Investors*, New York Attorney General (Feb. 17, 2021), available at <https://ag.ny.gov/press-release/2021/attorney-general-james-sues-shut-down-illegal-cryptocurrency-trading-platform-and>; see also



Complaint, *New York v. Coinseed, Inc.*, (N.Y. Sup. Ct. Feb. 17, 2021), available at https://ag.ny.gov/sites/default/files/the_people_of_the_stat_v_the_people_of_the_stat_complaint_2.pdf.

³⁹ *Attorney General James Seeks Court Order Immediately Halting Continued Fraud by Illegal Virtual Currency Trading Platform*, New York Attorney General (May 7, 2021), available at <https://ag.ny.gov/press-release/2021/attorney-general-james-seeks-court-order-immediately-halting-continued-fraud>.

⁴⁰ See, e.g., *State v. Espinoza*, 264 So. 3d 1055, 1063 (Fla. Dist. Ct. App. 2019) (reversing dismissal of criminal charge for unlawfully selling Bitcoin without a license and rejecting arguments that Bitcoin was not subject to Florida's money transmitter statute).