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DAOs in CFTC's Enforcement Crosshairs

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On September 22, the Commodity Futures Trading Commission ("CFTC") asserted its jurisdiction over a decentralized autonomous organization ("DAO") and its founders, signaling for the industry that even an unincorporated association cannot violate U.S. commodity derivatives regulations. This enforcement action exemplifies a novel approach to liability for violations under the Commodity Exchange Act ("CEA") and the CFTC's jurisdictional reach over decentralized markets in digital assets. CFTC Commissioner Summer K. Mersinger issued a dissent, arguing that this action is regulation by enforcement and an impermissible exercise of CFTC's jurisdiction.

First, the CFTC announced that it had reached a settlement with bZeroX, LLC (a decentralized Blockchain-based software protocol) and its founders for illegally offering leveraged and margined commodity transactions for retail participants in digital assets without being registered as a designated contract market ("DCM"), engaging in activities of a futures commission merchant ("FCM") without registration and failing to adopt a customer identification program.

Second, simultaneously with the settlement, the CFTC filed a federal civil enforcement action in California charging Ooki DAO (a successor to bZeroX) with the same violations as the first action. Ooki is an unincorporated association comprising holders of Ooki DAO Tokens ("Ooki Tokens") who vote these tokens to operate the Ooki Protocol. CFTC's reach over Ooki DAO Protocol via the Ooki Token is, according to Commissioner Mersinger's dissent, regulation by enforcement. However, even the dissent noted that "blatant" violation of the CEA cannot be tolerated, especially if it was the intention of the founders to make the new venture (*i.e.*, the DAO) enforcement-proof while knowing that the CEA was violated.

The CFTC presented the following analysis:

1. Cryptocurrencies are "commodities," which has been established law for several years now. As such, the CFTC has "general" jurisdiction to prosecute for fraud and manipulation in the interstate commerce.
2. If there is a leveraged contract on a "commodity" (*i.e.*, a contract is margined), then the CFTC immediately can exercise its "exclusive" jurisdiction, meaning it can dictate how, where, under what circumstances, and when a derivative contract can trade. Contracts offered through the Ooki DAO Protocol were clearly derivatives and, therefore, the CFTC could exercise its exclusive jurisdiction.
3. If a derivative is offered to a "retail" participant (*i.e.*, entities that are not eligible contract participants (ECPs)), then these contracts can only be traded on a registered DCM. Ooki DAO is not registered as a DCM.
4. Only FCMs can act as brokers or facilitators to execute retail commodity transactions and hold customer margin. Neither bZeroX (and its successor, Ooki DAO) nor its founders were registered as FCMs.
5. It is noteworthy that the CFTC did not charge Ooki DAO Protocol for operating as but failing to register as a DCM. In all likelihood, the CFTC could not reasonably argue that an unincorporated association governed by Ooki DAO Token holders can register as a DCM because it is not a legal entity. CFTC prior enforcement action in January 2022 involving another DeFi entity specifically sanctioned this entity for failure to register as a DCM.
6. Finally, this enforcement action and a complaint stand out in the context of SEC's Wahi complaint, which was also characterized as "regulation by enforcement" by CFTC Commissioner Caroline D. Pham. In the Wahi complaint, unlike in the Ooki complaint, DAO tokens were characterized as securities.

It is clear that the CFTC's Ooki settlement and complaint and the SEC's complaint in Wahi are breaking new ground for both CFTC and SEC jurisdictional reach while the agencies grapple with conceptualizing new technology and what entities would constitute a trading facility. The CFTC generally has been expanding the scope of a "trading facility" – *e.g.*, with respect to swap execution facilities ("SEFs") in September 2021. The SEC has done the same with its Reg ATS proposal in January 2022, and so did the ESMA in the EU with the April 2022 trading facility proposal. It is clear that the concept of a trading facility is undergoing a fundamental reevaluation, and there is no doubt it will be much broader and much more flexible in the very near future.

Likewise, in the absence of clear guidance from Congress, the CFTC and the SEC will continue to grapple on an *ad hoc* basis with their jurisdictional and definitional matters.
