A federal judge just made the first ruling on crypto — here's what it says

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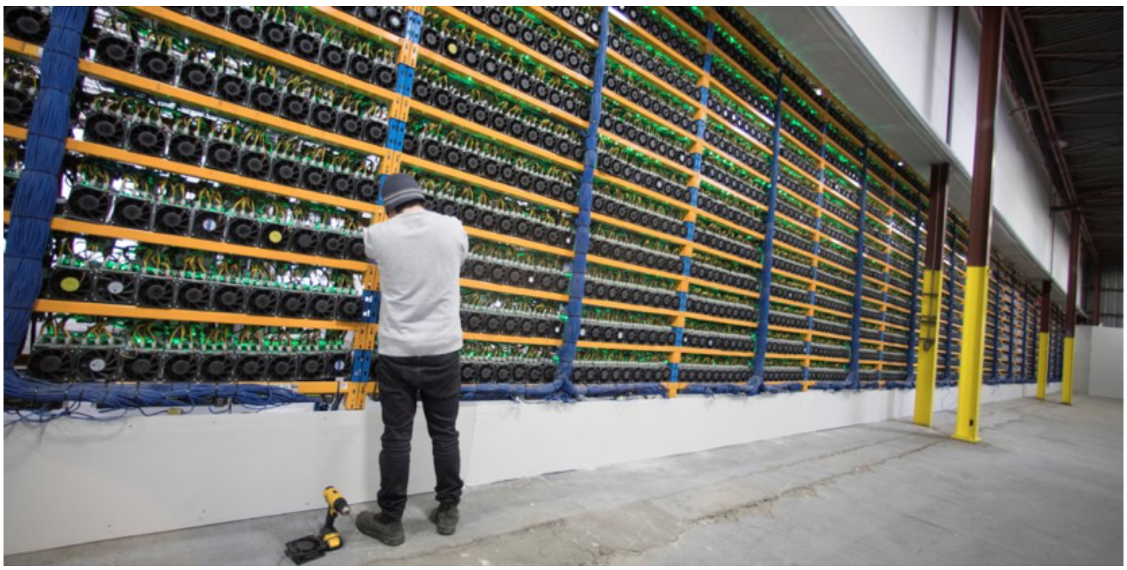

A worker checks the fans on miners, at the cryptocurrency farming operation, Bitfarms, in Farnham, Quebec, Canada. Reuters/Christinne Muschi

- **A US federal judge ruled that cryptocurrencies are a commodity.**
- **Cryptocurrency price manipulators can now go to jail.**

The past three months have been tough on cryptocurrencies. Bitcoin is down 53% from its peak, Ethereum 48%, Ripple 78%. From the respective peaks among the three, $350 billion have evaporated. Those are just the three largest by market capitalization. New ones come on the scene all the time, *still*. There are about 1,550 of them. So the question is this: What caused prices to surge so far so fast? And why have they collapsed?

Epic price manipulation is one of the reasons. That has long been known, propagated, praised, and lamented on crypto discussion boards. But it has become so spectacularly rampant - and the fiat currency amounts so large - that it has made its way into the mainstream media.

There are the bots designed to inflate prices. And there are humans. And worries "that the prices of Bitcoin and other digital tokens have been artificially propped up by a widely used exchange called Bitfinex, which has a checkered history of hacks and opaque business practices," the New York Times reported. "Could Price Manipulation Be Killing Bitcoin?" Vanity Fair asks. "Market manipulation a rising fear," CBS reports. But it's not a new phenomenon:

> A recently published academic paper in the Journal of Monetary Economicsfound that a single trader likely drove the price of bitcoin from $150 to $1,200 during a two-month period in 2013 on the Mt. Gox Exchange. Mt. Gox collapsed a year later after a theft of $460 million was discovered.

And why would any of this surprise anyone? Unregulated digital entities, created by just about anyone out of nothing, that assume some value denominated in fiat currency simple because they're being traded between anonymous people or bots whose only desire is to make prices go up, on unregulated opaque exchanges where everyone thinks price manipulation is good as long as it pushes up the price....

Problems and dissatisfaction with the system only arise when prices collapse, as manipulated prices always do, and as they already have.

Cryptos were new entities, and those that traded them thought they operated beyond regulatory authorities, laws, and jurisdictions. But that theory underwent a radical change recently. Turns out, as of this week, a US federal court agreed that regulators have the authority to send cryptocurrency price-manipulators to jail in the US.

In 2015, the Commodity Futures Trading Commission (CFTC), which was beginning to crack down on unregistered firms that were trading cryptocurrency derivatives, determined that cryptos were commodities and thus within its regulatory jurisdiction. It then ordered bitcoin-options trading platform Coinflip and its CEO to cease trading since they'd violated CFTC regulations. It also filed, and simultaneously settled, charges against Coinflip.

The CFTC's theory that it had authority to regulate cryptos was tested in court in a case, filed in January, where the CFTC alleged that defendants Patrick McDonnell and his company Coin Drop Markets were operating a fraudulent scheme involving cryptocurrency trading and misappropriating investor funds. Part of the defense was that the CFTC didn't have standing to sue because it didn't have the authority to regulate cryptocurrencies.

Last Tuesday, US District Judge Jack Weinstein for the Eastern District of New York ruled that cryptocurrencies are indeed commodities under the Commodity Exchange Act (CEA) and therefore subject to the CFTC's anti-fraud and anti-manipulation enforcement authority. This allowed the case to go forward.

With big repercussions, according to an analysis by Skadden, Arps,Slate, Meagher & Flom, one of the largest law firms in the US.

> Granting the CFTC's request for a preliminary injunction against the defendants who allegedly engaged in deception and fraud involving virtual currency spot markets, Judge Weinstein noted that "[u]ntil Congress clarifies the matter," the CFTC has "concurrent authority" along with other state and federal administrative agencies and civil and criminal courts over transactions in virtual currency.

Skadden's analysis:

> The primary issue before the court was whether the CFTC had standing to sue the defendants under the CEA. To resolve that issue, the court had to determine whether (1) virtual currency may be regulated by the CFTC as a commodity and (2) the CEA permits the CFTC to exercise jurisdiction over fraud in connection with commodities that do not directly involve futures or derivative contracts.
>
> The court answered both questions in the affirmative and held that the CFTC can pursue fraud and manipulation claims in virtual currency spot markets.
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> First, the court found that the term "commodity" encompasses virtual currency "both in economic function and in the language of the statute."
>
> According to the court, virtual currencies are "'goods' exchanged in a market for a uniform quality and value." As such, the court reasoned that they "fall well-within" the common definition of commodity as well as the CEA's broad definition of commodity, which includes "all other goods and articles ... and all services, rights, and interests ... in which contracts for future delivery are presently or in the future dealt in."
>
> Second, the court held that the CEA grants the CFTC enforcement authority over fraud or manipulation in both derivatives markets and underlying spot markets. In so ruling, the court nonetheless recognized a significant distinction regarding the CFTC's regulatory authority over derivatives markets on the one hand and over cash or spot transactions on the other.
>
> Unlike the full regulatory authority the CFTC exercises over the derivative markets, the court explained that the CFTC's authority over the spot markets extended only to "manipulation or fraud." For the CFTC's limited spot market authority, the court pointed to the CEA's anti-manipulation and fraud provisions under Section 6(c) and CFTC regulations implementing those provisions that prohibit employing a fraudulent scheme "in connection with ... a contract of sale of any commodity in interstate commerce."

This was the first ruling by a federal court to confirm the CFTC's determination in 2015 that cryptos are commodities under the Commodity Exchange Act, that it can regulate them, and that it can pursue those it alleges to have engaged in fraud and manipulation schemes on crypto exchanges. The CFTC has already filed other enforcement actions of similar nature.

With price manipulation - which was part of the fuel under the surge in prices over the past few years - now becoming a risky rather than a risk-free activity in the US, cryptos are going to face an uphill battle. Cryptos are a lot more fun when you can freely and by hook or crook manipulate prices up and watch the fruits of your handiwork balloon into endless perceived wealth than when these manipulated prices suddenly run out of this fuel and plunge. Turns out, a good time was had by all, but it didn't last forever.

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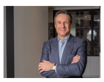

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