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Am Law Lawyers Help Bring Bitcoin to the Masses

The alternative currency's move toward the mainstream is the latest wrinkle in a so-called emerging payments sector that some firms see as offering growth opportunities.

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The Am Law Daily

2013-08-08 11:44:20 AM

It may be awhile before Kathleen Moriarty lets clients pay her in bitcoin, but the Katten Muchin Rosenman partner is doing her part to help legitimize the digital currency [derided as speculative and risky by some prominent economists](#).

In July, [Moriarty filed with the Securities and Exchange Commission](#) what appears to be the first-ever proposal to create a bitcoin-based, exchange-traded fund on behalf of two high-profile clients: Cameron and Tyler Winklevoss, the twin brothers famous for battling Mark Zuckerberg over Facebook's origins.

The filing followed [the twins' announcement that they had amassed some 92,000 individual bitcoins](#)—strings of code created, or “mined,” when a computer solves a complex cryptographic mathematical problem—worth about \$11 million. Now, the brothers hope to woo others to invest in bitcoins and are betting that tradable stocks tied to an ETF is the way to do it.

The twins turned to Moriarty because of her extensive experience with ETFs. Among other things, she helped create the country's first successful version—Standard & Poor's Depositary Receipts, which was composed of S&P 500 stocks and designed to track the index—in 1993 while she was an Orrick, Herrington & Sutcliffe partner. In the 20 years since, trading in ETFs in the United States has grown into a \$1.48 trillion market, [according to the Investment Company Institute](#).

Moriarty says she took the brothers on as clients without an expectation that the bitcoin phenomenon will ever go fully mainstream. Her focus is on the legal questions linked to creating an investment vehicle based on an alternative currency.

“It's kind of a continuum,” she says. “If someone handed me packets of cocaine and said, ‘Would you create an ETF?’ I would obviously say no. And obviously, if someone came to me and said, ‘Can you put together this 500-basket-of-stocks product?’ the answer was a simple yes. Anything else that anyone has an idea about, as a lawyer, principally, you're not thinking of how successful it will be in the marketplace, you're more thinking about the legal parameters, issues, and problems.”

Bitcoin, which can be used to purchase goods or traded for other types of currency through online exchanges, poses several potential problems. One is volatility, given that bitcoin exists apart from governments and central banks. Consider that in a single day in April, the price of an individual bitcoin plummeted from a peak of \$266 to \$105 before leveling off at \$150. Because the value of the proposed ETF shares would track the value of bitcoins themselves, similar swings are possible.

Security is another major concern. Individual bitcoins are typically stored in online “wallets.” However, as the Winklevoss brothers note in their SEC filing, these wallets are susceptible to hacking.

Moriarty says a bitcoin-based exchange-traded commodity (ETC) would address some of these issues in the same way gold-backed ETFs resolved security and storage issues related to bullion: “The thought was that maybe, like precious metals, it’d be easier to put them all in one place and have shares of that pool.”

As laid out in the Winklevoss filing, the idea is to pool a quantity of bitcoins in a trust, store them securely, then issue shares on the open market in the form of an ETC or redeemed for bitcoins held in the trust. The value of the shares, the brothers say, would mirror the price of bitcoins. Such a mechanism would let investors trade in the currency while reducing the risk of hacking and more general inconvenience.

Should the Winklevosses’ proposal win SEC approval, there would be three ways to enter the bitcoin market: investing in the ETC, buying bitcoins through an online exchange, or mining individual bitcoins directly. (The cryptographic protocol governing bitcoin halves the number of individual coins produced every four years, capping the number of coins to be produced by 2140 at 21 million.)

That the SEC has not yet determined whether bitcoin is a commodity, as the brothers’ filing contends, makes this particular investing concept much different from those Moriarty has worked on before. A favorable SEC determination, she says, would pave the way for the proposed ETF’s creation: “The question of what kind of an asset it is an issue that is going to be front and center.”

Whatever it decides, the SEC would be the second federal agency to rule on the nature of bitcoins. In March a U.S. Department of the Treasury financial crimes enforcement unit advised bitcoin exchanges that they must abide by existing anti-money laundering rules. The Commodity Futures Trading Commission and the Internal Revenue Service, meanwhile, have been silent on the subject to date, despite [a May report from the Government Accountability Office](#) that discussed the IRS’s responsibility to provide taxpayers with guidelines about bitcoin and other forms of virtual money, which the GAO likened to foreign currency.

Moriarty agrees that the U.S. government must address the issue. “Most of the regulation is on the fairly light side, because it’s a novel concept,” she says. “And the regulators are going to have to figure out how they are going to characterize these things.” (In some ways, the courts appear to be out in front of the regulators. On Tuesday [a federal judge in Texas ruled that bitcoin is indeed a form of currency](#) and that SEC lawyers could proceed with a suit against an individual accused of operating a bitcoin-based Ponzi scheme.)

Moriarty isn’t the only Am Law 100 lawyer working in this sphere. Though several bitcoin exchanges and wallet providers contacted by The Am Law Daily declined to identify their outside legal counsel, Bitcoin Foundation general counsel Patrick Murck cites Arnold & Porter, Perkins Coie, and Wilmer Cutler Pickering Hale and Dorr as firms with roles advising companies connected to the so-called crypto-currency.

The foundation—which tackles security and regulatory issues for individual bitcoin investors and those who operate exchanges and wallets—retained Perkins Coie as outside counsel to handle [a May 30 cease-and-desist order](#) issued by the California Department of Financial Institutions, which sought to bar the foundation from transmitting money in California without proper authorization. In a July 1 letter, the foundation argued that it is not a money transmitter and that its trading in bitcoin is therefore not governed by the California Money Transmission Act.

Says Murck: “I often tell people that I have a privileged role in that I get to watch entrepreneurs build global financial institutions outside the control of any institution and put control back into the hands of consumers, and I get excited every morning to get up and see what people are doing.” He applauds the Winklevosses’

proposal: "I think it's great because it will open the door to a public conversation about bitcoin which is long overdue."

Bitcoin's emergence is the latest wrinkle in a so-called emerging payments sector that some firms see as a growth area. In fact, several firms have launched practice groups dedicated to the field in recent years, including Patton Boggs, which represented gold-backed digital currency business e-gold Ltd., and K&L Gates, which advised American Express in connection with the creation of BlueBird, an alternative to checking accounts offered by Wal-Mart.

Andrew Lorentz, a Davis Wright Tremaine partner who focuses on the retail financial services industry and has advised companies on bitcoin matters, confirms that law firms' interest in expanding their efforts in the emerging payments sector is on the rise.

One sign of a surge: Lorentz has been helping to organize a conference on emerging payments systems for the past three years. After launching in Washington, D.C., the conference is now held on both the East and West Coasts. Attendance has grown from the 50 people on hand for the initial conference to the roughly 100 set to attend this year's East Coast edition in September.

"If you conceptualize it the way we are, we aren't alone in seeing it as a good place to practice," he says, noting that the firms in question combine parts of well-established law practices, like intellectual property and financial services, to assist their clients. "It's a growth area, and the law firms are certainly looking for places to deploy financial services expertise."

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