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Blockchain Legal and Market Trends

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How are venture capital and other asset classes deploying funds to blockchain based business models? What are the latest theses from investors as to why to invest in blockchain? How have blockchain based businesses been affected by the global pandemic and economic crisis that ensued? How are they positioned to recover?

“The Blockchain Report 2020: Financing, Themes, Coronavirus, & The Year Ahead,”¹ released recently by research company CB Insights, reviews the blockchain and cryptocurrency landscape in 2019 while providing a window into 2020 with the impact of COVID-19.

Meanwhile, regulatory and enforcement bodies are standing firm in their mission to protect investors based on the existing statutory and regulatory frameworks, that were not written in contemplation of distributed ledger technologies.

BITCOIN WAS ON TOP UNTIL COVID-19

Last year, Bitcoin’s price nearly doubled despite dampened media coverage, and Goldman Sachs named it the best-performing asset in 2019.

However, since the onset of the coronavirus, Bitcoin is down about 30 percent year-to-date.

According to the report, in 2019, “Crypto not blockchain” was the primary narrative as Bitcoin was over 90 percent, while investors continued to fund companies building crypto infrastructure. Meanwhile, incumbent financial institutions looked to expand service offerings in areas like custody and trading. And in 2020, amid the Covid-19-driven market sell-off and recovery, Bitcoin still acts as a risk-on asset, however companies continue to launch products that benefit the ever-growing blockchain ecosystem.

DEALS ARE MOVING EAST

In 2015, 51 percent of deals were for United States-based companies while only two percent went to China-based companies. Then, in 2019, the U.S. share of deals dropped to 31 percent and China’s increased to 22 percent – showing that crypto and blockchain investments are moving towards emerging markets in the east.

During the coronavirus pandemic, there have been concerns about how it would affect the growth of technology in China. The country has actually used blockchain technology to keep track of the supply of virus prevention materials, manage medical data, and in getting public opinion. In fact, Blockchain.News has reported² about 20 blockchain-based applications have been designed to address problems relating to the spread of

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coronavirus in the first two weeks of February. Most of these apps have been created to manage personal data of those in the region as they return to work.

ENTERPRISE BLOCKCHAIN FUNDING HAS SLOWED

Efforts to reduce back-office costs and improve business processes are continuing. However, over the last five years, funding to other applications has been almost seven times higher than to enterprise blockchain.

According to the report, Fenbushi Capital and Blockchain Capital topped the charts as the most active VCs between 2015 and 2019, while Neo Global Capital and Coinbase Ventures were the most active VCs in 2019. Meanwhile, equity funding to crypto and blockchain companies overtook initial coin offering (“ICO”) funding in 2019 as the ICO boom of 2018 collapsed under regulatory scrutiny. In 2019, total funding through ICOs fell to \$371 million. In comparison, crypto and blockchain companies raised \$2.8 billion in equity funding in 2019.

Between 2015 and 2019, VC-backed deals and financing into enterprise blockchain—defined as software for enterprise processes excluding holding or trading cryptocurrencies—has been dwarfed by funding to cryptocurrency companies. In 2019, cryptocurrency companies received \$2.3 billion in VC-backed funding while enterprise blockchain received \$434 million. In fact, almost half of the enterprise blockchain funding came from one deal – Ripple. This \$10 billion company that uses cryptocurrency to transfer money across borders announced the close of a \$200 million fundraise late last year.

In addition, Bitcoin was called the best performing asset in 2019 by Goldman Sachs. The cryptocurrency’s price surged 93 percent in 2019, but the sell-off in 2020 erased many of those gains, dropping to 28 percent.

CENTRAL BANKS GET SERIOUS ABOUT FIAT DIGITAL CURRENCIES

It turns out that the future of programmable money could come out of a central bank, not a startup. According to the report, 80 percent of surveyed central banks across the globe are exploring central bank digital currencies (“CBDCs”). In fact,

China has filed more than 80 patents related to CBDCs. And, even though the United States has shown openness to some areas of crypto, it is still cracking down on others.

Looking into the near future, government involvement in cryptocurrencies is set to grow. With the launch of CBDCs, governments may implement regulations to discourage the use of non-fiat cryptocurrencies. So, increasing competition among crypto service providers will drive diversification and the addition of high-margin, value-added services to attract consumers.

LEGAL AND REGULATORY OVERSIGHT ON THE HORIZON

In an interview with Bloomberg, Jay Clayton, the chair of the Securities and Exchange Commission (“SEC”), reportedly said:

I think a lot of people got excited that somehow we would change the rules to accommodate the technology and they invested their time and effort thinking that would happen. . . . I have been pretty clear from the start, that ain’t happening.

As we look to the end of 2020 and beyond, irrespective of the administration in Washington, we should expect to see regulatory and enforcement actions that protect investors based on the existing statutory and regulatory scheme in place for decades. The settlement between the SEC and Telegram was a case in point.³ Businesses that build new technologies to comply with existing statutory and regulatory schemes will win the race to hegemony, and those that push ahead where there is no legal safe harbor will be met with failure.

Notes

1. CB Insights, “The Blockchain Report 2020: Financing, Themes, Coronavirus, & The Year Ahead,” available at https://www.cbinsights.com/reports/CB-Insights-Blockchain-Report-2020.pdf?utm_campaign=marketing_blockchain_2020-03&utm_source=hs_automation&utm_medium=email&utm_content=84940793&_hsenc=p2ANqtz-_MIZNtvPOI_bZcn6r80nb_NfnT9dxd6ee3qUj-NpKm780O0dxTiy5Pc3ZffhvRshYP5K_KLrB9Kru-WWvhRBTs mC_9AA&_hsmi=84940793.

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2. <https://blockchain.news/news/blockchain-increasingly-leveraged-by-china-to-combat-coronavirus-outbreak>.
 3. SEC Press Release, “Telegram to Return \$1.2 Billion to Investors and Pay \$18.5 Million Penalty to Settle SEC

Charges” (June 26, 2020), available at <https://www.sec.gov/news/press-release/2020-146>.

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