

Insights

FIFTH CIRCUIT RULES OFAC CANNOT SANCTION TORNADO CASH

LOPER BRIGHT HAMSTRINGS OFAC'S CAMPAIGN AGAINST CRYPTO LAUNDERING

Dec 18, 2024

Shortly before Thanksgiving, a panel of the United States Court of Appeals for the Fifth Circuit ruled that the Office of Foreign Assets Control ("OFAC") did not have the authority to sanction Tornado Cash, which offers a cryptocurrency mixing service provided through immutable smart contracts.

^[i] Users interacting with these immutable smart contracts can obfuscate the source of their digital assets. Under the International Emergency Economic Powers Act ("IEEPA") and the North Korea Sanctions and Policy Enhancement Act ("NKSPEA"), OFAC has the authority to regulate or block "property" in which a "foreign national" or "person" has an "interest."^[ii] In 2022, OFAC sanctioned Tornado Cash by placing its website and 37 wallet addresses on OFAC's list of Specially Designated National and Blocked Persons ("SDN") list, accusing Tornado Cash of being used to launder over \$7 billion of cryptocurrency, including by the infamous North Korean Lazarus hacking group.^[iii]

Six users of Tornado Cash sued the Department of Treasury and OFAC on the grounds that OFAC's action violated the Administrative Procedure Act.^[iv] They reasoned that OFAC did not have the authority to designate Tornado Cash as an SDN because it is not a "foreign national" or "person," its immutable smart contracts are not "property," and Tornado Cash does not have a "property interest" in the immutable smart contracts. Disagreeing with the plaintiffs, the district court granted the Treasury Department's and OFAC's motion for summary judgment. Giving "heightened deference" to OFAC's definition of "property," the district court ruled that Tornado Cash was an entity that could be properly designated an SDN, the immutable smart contracts were "property" and the decentralized autonomous organization ("DAO") that runs Tornado Cash has an "interest" in the immutable smart contracts as they generate revenue to the DAO from the cryptocurrency mixing services they perform for users.

The Fifth Circuit panel reversed the district court. Invoking the Supreme Court's ruling in *Loper Bright v. Raimondo*,^[v] the panel found that the district court erred in giving deference to OFAC's definition of "property." In keeping with the Supreme Court's directive in *Loper Bright*, the panel undertook its own independent interpretation of the statutory language of the IEEPA and NKSPEA.

Pointing to what it sees as a long history of scholarship starting with William Blackstone regarding the term “property,” the panel noted that “when someone has a property interest, he or she typically has the ‘rights of possession and control.’ And ‘one of the most essential sticks in the bundle of rights that are commonly characterized as property’ is ‘the right to exclude others’.”^[vi] After the sponsors of Tornado Cash irrevocably removed the ability for anyone to control the lines of code that operate the smart contracts’ mixing functions, no one can exclude others from using them. Thus, the panel concluded that Tornado Cash’s immutable smart contracts could not constitute “property” which OFAC has the authority to block under the IEEPA and the NKSPEA. No one can control the smart contracts and no one can exclude others from using them.

While the Fifth Circuit panel’s ruling is novel, its reach is potentially limited. Many DAOs operating decentralized networks retain some control of their affiliated network services. In those cases, it would seem that the *Van Loon* reasoning would not apply. If a DAO has some level of control over the operation of its decentralized network or the ability to exclude some parties’ access to the network, it seems the mutable smart contracts could constitute “property.” Federal courts have held that a DAO is a person capable of suing and being sued.^[vii] As a result, a DAO could be a person with an interest in smart contract property where the network generates fees paid to the DAO to compensate it for providing a governance function for the network.

With its ruling against OFAC in *Van Loon*, the Fifth Circuit maintains its reputation for being a hospitable forum for challenges to the federal government. *Van Loon* follows on Fifth Circuit decisions in *Jarkesy v. SEC*^[viii] ruling the SEC’s administrative adjudicatory system to be constitutionally flawed, *Chamber of Commerce v. SEC*^[ix] declaring the SEC’s adoption of a share repurchase rule to be arbitrary and capricious, *Clarke v. CFTC*^[x] finding the CFTC’s withdrawal of a no action letter to be arbitrary and capricious, *CFTC v. EOX Holdings*^[xi] concluding that the CFTC had not given fair notice that a CFTC ruled prohibited the conduct at issue, and its recent *en banc* decision in *Alliance for Fair Board Recruitment v. SEC*,^[xii] striking down the SEC’s approval of NASDAQ’s listed company board diversity rule. It will be interesting to see if this trend continues after the new administration takes office early next year.

FOOTNOTES

[i] *Van Loon v. Treasury Dep’t*, 2024 WL 4891474 (5th Cir. Nov. 26, 2024) (“*Van Loon*”).

[ii] 50 U.S.C. § 1702(a); 22 U.S.C. § 9241(a)-(c).

[iii] [U.S. Treasury Sanctions Notorious Virtual Currency Mixer Tornado Cash](#) (U.S. Treasury Press Release Aug. 8, 2022).

[iv] 5 U.S.C. §§ 551 – 559.

[v] 144 S. Ct. 2244 (2024).

[vi] *Van Loon* at *9 citing Black’s Law Dictionary, *United States v. Craft*, 535 U.S. 274, 278 (2002) & *Dickman v. Commissioner*, 465 U.S. 330 (1984).

[vii] *CFTC v. Ooki DAO*, 2022 WL 17822445, *4 (N.D. Cal. Dec. 20, 2022); *Sarcuni v. bZx DAO*, 664 F. Supp.3d 110, 1115 (S.D. Cal. 2023).

[viii] 34 F.4th 446 (5th Cir. 2022).

[ix] 85 F.4th 760 (5th Cir. 2023).

[x] 74 F.4th 627 (5th Cir. 2023).

[xi] 90 F.4th 439 (5th Cir. 2024).

[xii] 2024 WL 5078034 (5th Cir. Dec. 11, 2024).

MEET THE TEAM



Katherine Cooper

New York

katherine.cooper@bclplaw.com

[+1 212 541 1141](tel:+12125411141)

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.