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**Podcast Transcript**

# Four Areas Online Retailers and Ecommerce Companies Should Know about Cryptocurrency

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Kattman: From do-it-yourself giants to grocery stores and even major coffee companies, more and more retailers are incorporating cryptocurrency into their day-to-day business. But as any with any emerging trend or new market, there are always questions and issues to navigate. So, what do online merchants and e-commerce companies need to know to traverse this new frontier? I am Amy Kattman, and you are listening to BakerHosts.

On today's episode, Partner Jeewon Serrato and Counsel Rob Musiala take you through the various ways companies are utilizing cryptocurrency and what emerging issues you need to know. Welcome to the show, Jeewon and Rob.

Serrato: Hi, thanks for having us.

Musiala: Hi Amy, nice to be here.

Kattman: Thank you, both. To get started today, I would like to start with you, Jeewon. Is cryptocurrency the future of retail?

Serrato: It is not going to take over, but it is definitely going to be another option that is becoming mainstream. More merchants are accepting cryptocurrency as payment every day. You can now use cryptocurrency to get groceries delivered, pay for games, buy clothes, and even order coffee. We are also seeing Bitcoin ATMs proliferate, including in many supermarkets. Access to cryptocurrency is becoming easier and that means there are more and more places to pay for things using cryptocurrency. We are going to be publishing a blog article focused on a play-to-earn NFT games where we are going to talk about this phenomenon that people can play online games to earn money.

The future is here, we think, where everyday people could earn cryptocurrency by playing games in a virtual world and then use it for everyday purchases, even without having to cash out into fiat currency. So, we think it is fascinating to look at what impact this is going to have on traditional measures of economic systems and financial institutions. Now, if we ask the retailers about this adoption trend, the common theme that we hear over and over again is that they want to give the customers what they want. Specifically, there is an element of wanting the online marketplace to respond to Gen Z buyers. There is a survey showing that 54% of current or former crypto owners are Gen Z, and retailers just do not want to leave out a whole segment of a telemarket as Gen Z's purchasing power is going to continue to increase.

Now, there are some skeptics that they say that maybe there is a more effective way to drive sales and create loyalty, and whether this appeal to Gen Z and younger generation is going to be a real driver for adoption of cryptocurrency is yet to be seen, but I think we will go out on a limb to say that it is not an open question anymore, the fact that all retailers should at least be considering whether and how to start accepting cryptocurrency as a payment.

Kattman: So, in addition to market demand, are there benefits to cryptocurrency that retailers might want to consider?

Serrato: Satisfying customer demand is definitely one of the main drivers, but accepting current cryptocurrencies has other benefits for retailers, payment security for one example, especially for high value purchases. Retailers could see high fraud rates on standard bank-based credit card payment systems, particularly from foreign buyers, and cryptocurrency-based payments can reduce that risk. Another example is that from a consumer's perspective, it enhances their confidence because consumers have secure access to the individual's cryptocurrency balance.

Retailers may also like it because there can be no chargebacks once a purchase is executed using cryptocurrencies. Now, we talked a bit about the use-case scenarios involving retailers receiving payment in crypto, but retailers are also considering paying in cryptocurrency for B-to-B vendors. So, some retailers may consider holding cryptocurrency themselves. The question usually begins first with retailers deciding whether to use a payment processor. So, Rob, could you explain the payment processor model?

Musiala: Sure. Thanks, Jeewon. The payment processor model is the easiest way for a retailer to begin accepting cryptocurrencies as payment, and the way it works is the retailer enters into an agreement with what is called a cryptocurrency payment processor. These are third-party vendors that are registered money services businesses and have the appropriate anti-money laundering programs in place to help accept cryptocurrencies, and the payment processor sits in between the transaction so that when a customer, especially an online customer, wants to make a payment in cryptocurrencies, the cryptocurrency goes to the payment processor.

The payment processor immediately converts that cryptocurrency into U.S. dollars or other fiat currencies at the spot rate in that moment in time, and then the payment processor remits an ACH or wire transaction to the merchant, and the benefit to this is, the merchant does not have to worry about any of the anti-money laundering concerns associated with accepting cryptocurrency payments. And also, the merchant does not have to deal with holding cryptocurrency and some of the security issues around that, and as well as the merchant does not have to deal with the issue of how to report cryptocurrency holdings on their balance sheet and financial statements. And so that is the easiest way for a merchant to begin accepting cryptos, is through a third-party payment processor vendor.

Serrato: So, those are all good reasons why you might want to use payment processor, but are there any reasons why a retailer would want to accept cryptocurrency without a payment processor?

Musiala: There may be good reasons, in fact, and it gets to some of the things that you were just speaking about, Jeewon. So, a payment processor model is good for a retailer that wants to accept cryptocurrencies from its customers and that is it. But there may be scenarios where a retailer or other business wants to actually be able to hold cryptocurrencies. One good reason would be, as you mentioned, what if that merchant wanted to actually pay its vendors in cryptocurrencies or pay others in its business ecosystem in cryptocurrencies? And that is going to become more and more common, especially for businesses that are closely linked to the cryptocurrency space. And so that is one reason to accept payment in crypto, you can then use that cryptocurrency to pay other persons in your ecosystem.

Another reason why some companies are starting to think about holding cryptocurrencies and accepting them without converting to U.S.D. is that cryptocurrencies can have value as a reserve asset on your balance sheet, and we have now seen some companies that are deliberately holding cryptocurrencies as a reserve asset, a kind of investment. There are issues that arise with that, including how to accurately record cryptocurrencies on your balance sheet and report them on your financial statements. There are issues around making sure that they are classified appropriately from the standpoint of regulators, and there are also custody issues, making sure that you maintain appropriate safeguards in place to custody those cryptocurrency assets appropriately. Oftentimes, that involves working with, again, another third-party custody vendor. But the prospect of holding cryptocurrencies on your balance sheet is increasingly something that companies are looking at as something that potentially has a very good upside for the company as a reserve asset.

And then lastly, and this is probably the most emerging, is there are more and more companies that are experimenting with the concept of holding onto cryptocurrencies for the treasury management benefits that they may provide, and specifically this arises, especially when you think about what are called stable coins, which are cryptocurrencies where each unit is backed one-to-one by a real U.S. dollar in a real U.S. bank account, and if you are holding onto stable coins, that could offer significant benefits for intracompany treasury management systems where you are taking advantage of some of the efficiencies of being able to transfer funds on a blockchain. And so, those are some of the reasons why companies may, as their cryptocurrency strategies evolve, may want to think about evolving from that payment processor model into a model where they are actually holding those cryptocurrencies themselves.

Kattman: Rob, could you talk about how cryptocurrencies improve supply chain management?

Musiala: Sure, and I am just going to touch upon this briefly, but I want to mention that we get into this concept of blockchain for supply chain management in pretty good detail in one of our earlier podcasts. It is the one entitled Beyond Cryptocurrency: Non-financial Use Cases for Blockchain. So, I would encourage listeners who are interested in learning more about blockchain for supply chain to take a listen of that podcast.

But in general, cryptocurrencies can improve supply chain management by improving the cash flow systems in supply chains through processes where through the use of smart contracts, instant payments in cryptocurrencies can be made upon the occurrence of predefined and pre-agreed events. And so, for example, when a product in a supply chain reaches a point in time where it is transferred from one party to the next party, a smart contract function may be able to be enabled whereby instant payment is made in satisfaction of that change of custody of the product, and so that is an example of how a cryptocurrency payment can improve the cash management functions of parties in a supply chain system.

Serrato: How about when you are engaging in R& D for using blockchain? I know this is a topic that you talked about at length during that podcast that you mentioned, but could you briefly touch on it?

Musiala: Sure. The idea of having a good research and development strategy when you are thinking about cryptocurrencies and blockchain in the supply chain context is important because while in the simplest respects, cryptocurrencies can be used a payment to sort of take advantage of those cash flow efficiencies, as supply chain, as you kind of think about it more and more, that payment function can be integrated with enterprise grade blockchains or private permission blockchains that are used to manage the data involving supply chains. And the idea of being able to sync up that sort of private blockchain that is a data management tool with a payment function that is essentially a cash management and cash flow tool can be a pretty powerful thing, but it is a new thing that I think sort of triggers different issues that need to be thought through as those solutions are being developed, things like, is what I am building patentable? Are there trade secrets that are arising as I am building this solution? What are the data privacy issues involved in tracking and tracing products and making payments related to those products on a blockchain where the data is by and large immutable? And especially for enterprise grid blockchains that are being hosted by different, independent third parties that are acting as validators, what are the technical and organizational measures that you need to agree to in order to make those supply chains solutions work on an ongoing basis? And as I mentioned, we do get into more of these issues on that prior podcast.

Kattman: Thanks, Rob. How are cryptocurrencies and NFTs being used in advertising?

Musiala: They are being used more and more in advertising in a lot of different ways. Two that I want to highlight today are first, cryptocurrencies like Bitcoin and other popular cryptocurrencies are now being used as giveaways or rewards in loyalty programs, so retail businesses that sell product, that have a loyalty program, are now starting to actually just give away cryptocurrencies in small amounts to their loyalty customers, so that is one way. Another way with respect to NFTs, is NFTs are very new, and one of the latest, sort of, developments in this ever-fascinating marketplace, but NFTs among other things are being used as marketing tools.

So, an NFT, a non-fungible token, is essentially a cryptocurrency that has a media file attached to it, and that allows that holder to prove that they hold the original version of that media file. And that media file can be used as a marketing tool in the same way that we have seen retailers and other business use trademarks, logos, and other things that they have the copyright to in sort of products, things as simple as like a t-shirt or a coffee mug. That concept can now be translated to the digital space where a media image, say a piece of artwork, that may be based off of a company logo or a company trademark, can now be used as a marketing tool where it is bought and sold in the digital world and it is obviously marketing your product and your business at the same time.

Serrato: So, we know when we are working with companies that oftentimes the marketing team could have a campaign and they could be very innovative, and sometimes the legal teams are trying to play catch up. We are trying to figure out okay, what are some legal issues that might arise? So, Rob, could you tell about some of the legal issues that we should be advising our clients on that is related to transferring NFTs or cryptocurrency?

Musiala: Sure, and there are many of these, so I will just highlight a few that I think are pretty important. When we are talking about campaigns that involve transferring cryptocurrencies like Bitcoin or other popular currencies, the main issues to think through are to make sure that you are complying with any applicable anti-money laundering or OFAC and sanctions laws. When you are talking about NFTs it gets very complicated. NFTs or non-fungible tokens are an emerging market. They are one of the latest developments in the blockchain market and they continue to develop kind of at light speed, and there are many aspects of this market that fall into various legal grey areas, and here I will just take a moment to refer folks back to another earlier podcast that I did. It is called Everything You Need to Know About NFTs in Ten Minutes or Less, where I kind of get into a little bit more detail, but for today I want to just highlight a couple key risks.

The first with NFTs is when you are transferring an NFT to a third party in the sale of an NFT or otherwise. Generally, it should be done as a best practice through a trading platform, and a trading platform that is registered as a money services business. And that trading platform would then satisfy most, if not all, of the anti-money laundering and OFAC concerns related to the transfer. So again, AML and OFAC is a concern. With NFTs there are additional concerns related to compliance with the securities laws, and this is a very grey area where the SEC has been clear that each case is going to be looked at on its own unique facts and circumstances, and so it is highly advisable to seek legal counsel related to any NFT initiative.

But in general, there are certain things you can do to limit your securities law risk, the first of which is to kind of keep your NFT very simple. So, a non-fungible token or an NFT generally gives the holder of the NFT the right to access a media file, the right to transfer that NFT and the associated media file access to a third party, but more and more NFTs are being created that carry additional rights. And as you add additional rights above and beyond the ability to access a media file, that is where you may get into a situation where you are potentially running afoul of the securities laws. Now, I have seen many NFTs where the NFT gives the holder the right to receive a physical consumptive item that is of nominal value.

That generally is low risk, but as other features are added on to that NFT, it is highly advisable to seek legal counsel to make sure that you are not running afoul of the securities laws or putting yourself into a position where you might be. Two other things I will mention related to mitigating securities laws risk. NFTs should never be deigned, sold, or marketed as an investment opportunity, and then another thing I want mention is this concept of perpetual royalties has become very popular, and it is a very powerful thing that NFTs have enabled from a business and financial perspective.

But a royalty payment can really only go to the holder of a copyright, and so to the extent that so-called perpetual royalties are being thought about, if those payments are going to persons other than the holder of the copyright in the media, they may not be looked at as royalty payments in the eyes of the SEC. They may be looked at as other things that may potentially trigger the securities laws. So, there is a couple of the things that folks ought to consider as they are thinking about NFT initiatives, and there are of course many others. But overall, it is important to seek legal counsel because while this market has a lot of potential, I mean it is very exciting from a revenue generation standpoint, it is absolutely existing and evolving in a very grey legal area.

Kattman: Rob, let us talk about risks. What Foreign Corrupt Practices Act and other bribery risks exist in cryptocurrency?

Musiala: Sure, so the FCPA and bribery risks are the same as they have always been. It is just with cryptocurrency there is now a new method and a new means of executing bribes and other payments that could potentially trigger the FCPA. And so, what that means is that companies that need to be cognizant of the FCPA and other bribery risks, need to be cognizant of how cryptocurrencies sort of change the game and offer new methods of bribes and other corrupt payments.

Serrato: We talked about, earlier in the podcast, that security, payment security, is one of the reasons, one of the benefits of using cryptocurrency, but kind of to follow up on your earlier point about FCPA and bribery risks, we also know that there could be some unique issues that are related to insider threat or asset appropriation and fraud. Could you tell us a little about that?

Musiala: Sure. Just like cryptocurrencies create new methods of bribery and other corrupt payments, they also create new methods of insider threats including things like asset appropriation and other insider fraud. I will give two examples of how sort of cryptocurrencies can change the game. One is from a little over a year ago now. There was a Department of Justice investigation into an insider threat scenario where an employee on the tech team of a company figured out a way to steal prepaid gift cards. And, a prepaid gift card in many respects is just a bar code, and this employee was stealing those prepaid gift cards, selling the gift card on the dark web in exchange for cryptocurrencies, and then later exchanging those cryptocurrencies for U.S. dollars. And so that is a situation where the fraud is happening all outside of the traditional financial system until much, much later after the theft has already taken place, and so it becomes a lot more difficult to detect.

Another example that I will give is there have been several instances that I have heard about where employees acting as insiders have figured out ways to steal electricity from a company and harness that electricity to do their own cryptocurrency mining, so, where they are essentially stealing and running up the company's electrical bill and converting that electricity into cryptocurrencies. And so, these two examples I think are good, because the theft occurs wholly outside of the traditional financial system, and I think they highlight the reason why companies that have sort of internal audit functions, policies and procedures related to anti-bribery, anti-corruption, really need to think about how do we update those policies, how do we update those anti-corruption programs and internal audit and internal investigation programs to account for some of these unique aspects of this new way of payment and new way of value transfer.

Serrato: So, Rob, we started the podcast by talking a lot about the retailer use case scenario, and I know that some of our earlier podcasts talked about the different kinds of industries that are looking to adopt and to explore cryptocurrency and

NFTs. So, we talked about the benefits and then we ended up talking about the risks. I think that what is really interesting here and a takeaway for us is, that there are some unique issues that cryptocurrencies generate, and there are some risks along with the benefits.

Musiala: That is exactly right, Jeewon. Cryptocurrency is like any new technology, are a double-edged sword, so while they are creating lots of really exciting opportunities and new revenue generation opportunities, they are also carrying new risks for businesses. And so, the key to thriving in this market is to take advantage of the opportunities while appropriately understanding and taking steps to mitigate the risks that come along with those.

Kattman: Well, this has been really informative. Thank you, Jeewon and Rob.

Serrato: Thanks for having us.

Musiala: Thanks, Amy. It was a pleasure.

Kattman: If you have any questions for Jeewon or Rob, their contact information is in the show notes. As always, thanks for listening to BakerHosts.