

Exploring the AI and Crypto Intersection

CryptoCounsel

July 24, 2024

In this episode of the CryptoCounsel, Frank welcomes Nick Peterson, a white-collar and investigations attorney at Wiley, to discuss the intersection of cryptocurrency and artificial intelligence (AI). They explore the concept of AI washing and discuss how crypto mining operations are pivoting towards AI data processing. Nick provides insights on regulatory landscapes, enforcement trends, and practical advice for companies navigating these emerging technologies. Tune in for an engaging conversation that merges the dynamic worlds of crypto and AI.

Transcript

Frank

Welcome to the CryptoCounsel at Wiley. We are the podcast that decodes the most important crypto disputes and litigation and regulation. I'm Frank, a securities litigator who handles crypto disputes. My usual crypto co-counsel, Josh, is not here with me today but I have a very special guest here instead, my colleague, Nick Peterson.

Nick is a white collar and investigations attorney here at Wiley and he's obsessed with another technological space, AI. He and I are going to discuss the intersection of crypto and AI here.

Nick, welcome to the Crypto Counsel podcast.

Nick:

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Great. Thanks, Frank. I'm excited to be here.

Frank

Nick, not only are you a guest on the podcast - with Josh not here, you are going to get the special honor of doing our usual three quick bits. So I'm going to tell you about three things that are happening in the crypto world. You're not a crypto person, but you're going to do your best to play along.

Nick

Okay. Hit me with them.

Frank

All right. Quick bit number one. The Securities and Exchange Commission's Consolidated Audit Trail, CAT, became *"fully operational on May 31st of 2024."* CAT is the largest database of retail and institutional trading ever created; contains information on every equity and listed options order and trade processed in the U.S.. SEC-registered broker dealers, exchanges and alternative trading systems now have to collect and report trade information related to every U.S. trade, as well as personal information of every U.S. retail brokerage customer. So, the impact of CAT on the digital asset industry could be massive and industry trade associations and participants are actively calibrating their messaging on the system. CAT sounds really, really big. Nick, what wildlife big cat should we compare it to?

Nick

I think I'm partial to tigers. We'll go with that but yeah, CAT sounds interesting; big impact, huh?

Frank

The tiger is bigger than the lion, I believe. Which is a fact that confounds me a little bit.

Nick

Is, so is that the largest cat?

Frank

I believe it is the largest cat. Although I don't know where the liger fits in that.

Nick

And what about saber-toothed tigers? And we're going back historically -

Frank

Yeah, I feel like we're a technology podcast about historical you know, no-longer-with-us animals.

Nick

I'm very intrigued by those giant animals of yesteryear, like the massive sloths, giant bears, things like that. Favorite exhibits when I go to museums are the giant animals.

Frank

Woolly mammoth. Where are you on woolly mammoth?

Nick

I'm interested in them. I, do they, don't they have like DNA? Woolly Mammoth DNA now? That they're trying to recreate Woolly Mammoths?

Frank

Like Jurassic Park style?

Nick

I think so. I think that they're really doing that. They may be on the verge of, we may be having a podcast.

Frank

I feel like we've identified a new practice area.

All right, well, quick bit number two FTX, their plan to repay creditors is meeting a little bit of resistance in bankruptcy court. Under the plan, FTX proposes to repay up to 118 percent of the claims to creditors with 50,000 dollars or less, which is about 98 percent of the creditors overall in the bankruptcy proceeding. The settlements will be made in cash, but that's not enough according to objections filed by a group of FTX creditors who called the repayment plan - FTX is a topic that Josh and I are probably going to delve more into on this podcast.

But Nick, in the AI world, do you have anyone as colorful as Sam Bankman Fried?

Nick

Not yet, and frankly, I think it's going to be hard to top SBF and some of the other players in the crypto world. The AI world right now at least has a lot of the established tech companies that you're used to seeing. So those are, have been the leaders. There may be people who will pop up and hopefully not in a criminal context, but we may see some eventually but for now, I think it's largely the traditional players that we're seeing.

Frank

And quick bit number three, going back to the SEC, the SEC chair Gary Gensler recently told Congress that the commission might rewrite proposed rules governing broker-dealers' use of artificial intelligence and the handling of customers cryptocurrency assets based on robust feedback from industry participants and other commentators. The proposed rule was designed to regulate use of technology, like predictive data analytics that the commission has said could harm investors by steering them toward trades that they wouldn't otherwise have made. According to Gensler, *"we got a robust comment file on the predictive data analytics rule. A lot of people for, a lot of people against."* Gensler didn't say how the rule might change, but he did acknowledge that a recent court decision by the Fifth Circuit Court of Appeals could narrow the SEC's rulemaking power in this regard.

So, Nick, I have this image of a grownup version of Haley Joel Osment's character from the movie Artificial Intelligence providing stock buying tips. Is that what's going on here?

Nick

I would say that's the dream, that's the ideal, if we could get, get to a point, a point here, but no, I think this is the SEC, just like almost every other agency trying to get in on regulating AI and trying to keep their finger on the pulse of what's going on and making sure it doesn't get too out of control.

Frank

So, that is one way in which AI and crypto seem to be intersecting, but today we're going to now talk about sort of three areas that you're seeing either the intersection or maybe the coming intersection of those two spaces and I just want to hear about what you're thinking, what you're seeing from the AI perspective on crypto AI and how they sort of intersect.

So, do you want to just walk our listeners through those three things that you were telling me about before we started recording today?

Nick

Sure, and typically I would lay the foundation and explain what AI, but I'm assuming your listeners are sophisticated enough to know what AI is, have heard of generative AI and the various aspects of AI. I think you may not know the underlying architecture or how AI works, but most people don't and even some regulators may not and the first point I want to circle back to is sort of your last quick hit point about -

Frank

It's a bit, Nick. It's a quick bit. It's a technological joke.

Nick

I - It's all, it's open. My eyes are being opened right now.

Frank

Do you see it?

Nick

I do like it. I like the quick bits.

Frank

So just before, I want to get back to the very serious topic, but Josh and I had a little bit of a devolution in one prior episode because I think you and I and Josh were all of a certain age where 16-bit, 8-bit gaming was important to our lives.

So do you have a favorite 16-bit video game console?

Nick

So, was the original Nintendo 16 or 8-bit?

Frank

That was 8.

Nick

That was 8.

Frank

And then we moved to Super Nintendo and Genesis.

Nick

So I would say I played much more familiar with Super NES, but the Sega Genesis might have had my favorite game, which was World Cup Soccer, which is sort of an odd choice because I don't play soccer and have never played or I haven't really played FIFA Soccer on the newer consoles but World Cup Soccer for the Sega Genesis, where you could choose, I think, one of twelve teams, might be the purest, most excellent game ever created on the soccer stage.

Frank

That's fascinating. I don't think I played that game. We had the NHL game for Sega Genesis, which was epic. My dad and I would frequently play that but I agree with you that the Super Nintendo was the superior console overall.

Nick

Do you remember the Neo Geo?

Frank

Oh yeah.

Nick

Oh yeah, where you could plug it into the arcade. Very interesting. Did you ever think about instead of quick bits, quick bytes, but with a Y? Or that not come across?

Frank

It feels like if we were having a food blog and we were sort of going around sort of getting -

Nick

Quick bites of news? We're workshopping here.

Frank

I will take it back to my crypto co-counsel but anyway, getting back to our conversation in the first area that you were identifying.

Nick

And it's basically that I think a lot of people look at AI as the next big technological thing with crypto being sort of the first wave of some of these issues and there's starting to be some regulation, at least some attention on crypto.

I think when it comes to AI, there has been a lot more attention, a lot more focus by both regulators and legislators, and seemingly every agency is trying to figure out how to handle it. Some of them are passing rulemakings, like we just talked about the SEC rulemaking. A lot of other agencies are looking internally first to how they can build out their AI capabilities and understandings but pretty soon that's going to move. DOJ is paying close attention. FTC, a number of agencies. Then you also have The Hill - Congress is paying close attention. I think there were dozens of bills recently, probably in the last year or two, on at least dozens on what trying to regulate some aspects of AI. There's no comprehensive legislation yet, but I think there's efforts being made in that direction. The states are also going crazy, passing all sorts of AI rules and laws. I think there's something like, I don't want to put a number on it, probably a majority of the states have some type of

AI legislation right now, although, you know, again, not too many have comprehensive legislation.

But that's sort of a roundabout way of saying that there are going to be AI laws, AI regulations, that will most assuredly apply to crypto companies as well and I'm not talking necessarily about generally applicable laws that will apply to all companies, but certainly in the tech space that crypto companies should pay special attention to the developments of this AI legislation because they will, I think, be caught up in some of these rules and may not be completely obvious because the legislation will be targeting AI or we have an AI, you know, bill name or whatnot, but it will so swoop in and frankly, I think, crypto has gotten a lot of attention from regulators. AI is getting a lot of attention from regulators. If you combine the two, if there are crypto companies that use AI tools in their company, I think that's going to be a really juicy target for lawmakers who are looking at it and certainly regulators.

So that's something I would just flag. Hey, this is a fast-developing world, a lot of interest amongst the government, on the government side. So just keep a close eye on what's coming down. So, because it will be interesting and crypto companies will likely be not a target, so to speak, but you know, ensnared in some of these regulations.

Frank

Yeah, no, that makes a lot of sense and that's really interesting. One thing that Josh and I have talked about on the podcast and that we see a lot in the crypto space is regulation by enforcement where the SEC is not doing notice-and-comment rulemaking. They're actually going case by case and bringing enforcement actions against crypto companies, crypto exchanges, different kinds of crypto market participants to try to build a body of how the securities laws apply to crypto. Is that happening in AI?

Nick

Absolutely. I mean, they've already said, your quick bit was about the proposed rulemaking from SEC. They're going back to the drawing board. They've gotten a lot of comments but SEC has already acknowledged that they have active AI investigations. There have been a couple of charges and settlements that we can talk about in a little bit involving AI. I don't want to say necessarily AI companies, but involving sort of AI claims and I think there are more that haven't become public. So, I think that's where we're going to start to see the development of some of this AI regulation and certainly DOJ, FTC, some of the other agencies are also looking at it and I believe DOJ has said, we don't need any new laws, the laws on the books are sufficient to enforce the misuse of AI. So at least some of the agencies, DOJ primarily among them, have already taken a position that we can enforce things as written and we can, I don't want to say regulate it, but we can shape the use of it and punish bad actors.

Frank

And are there any prominent examples of AI companies pushing back on that pre-established authority in crypto? It's, there's a huge trend where the crypto companies are actually suing the SEC to say, look, you lack authority to do what you're doing. Has anything like that happened in AI?

Nick

Not yet, just because it hasn't gotten to the point of rulemaking and regulations. I mean they're proposed rules, but there are no final rules. So it's still this enforcement, you know, let's use the laws on the books to try to regulate it. Often what we're seeing is when there are enforcement cases, whether it's SEC or DOJ, there will be an AI component, but it won't be the sole component. There will be other bad acts involved, which, so they have the foot in both worlds and can point to the more traditional bad acts. So, we haven't seen a concerted push at least on how they're handling AI.

Frank

So, do you have a practical piece of advice for companies that may be in this sort of crypto-AI intersection or adjacency, in terms of how to move their business forward in light of this uncertainty?

Nick

I think you just have to be aware. If you are going to incorporate some type of AI tool or make any marketing claims, just be very intentional about it and try to look ahead because there may not be clear risks right at the moment, but that may not be the case a year from now when the AI tool you've incorporated into your business is now starting, you know, will conflict or give rise to obligations under a yet to be passed law.

Frank

Yep, makes a lot of sense. So, this might be a good opportunity to segue into the second trend or topic that you were telling me about, and you were telling me about a term that I had not heard before this podcast. Do you want to share with our listeners what that is?

Nick

Yeah. So the term is "AI-washing," and really I've only heard the SEC use it and I think they're really pushed, trying to lean into this term and what they mean by that is basically false statements regarding a company's use of AI. Now, we were talking a little bit about this beforehand, and I think this is not the right way to use the phrase "something, something, washing"; like "sports-washing" is when, if your listeners are familiar, usually a country that may have some, you know, bad policies or some other unfavorable aspect to it, dumps a bunch of money into some sporting event or sports teams or whatever to distract the people, the rest of the world basically, from all the other bad stuff they're doing.

That's not really how "AI-washing" is being used. It's not meant to distract people from something else bad going on. It's more of just a, we mean this to be the AI claims are like a veneer that there's no substance to it. There's just the claim and it's used to help; basically, it's fraud and that's already illegal, but now it has an AI bent because they call it "AI-washing". There have been a couple different cases involving what the SEC terms as "AI-washing".

Earlier this year, there were two investment advisor firms that settled with the SEC over claims that they used or touted their AI capabilities. That they had these AI tools that could use their customer or client data to make all these more or better investment decisions and, surprise, they did not actually have any such AI tools or capability.

More recently there was, I guess, a complaint filed – charge – against an AI company that claimed to be able to match companies with diverse candidates, or what they termed like, the second-best candidates. So, candidates who'd already been, gotten very far in the hiring process for some companies, and then just for whatever reason were not hired. So it was trying to match companies with diverse candidates in this position, and again, same type of idea, the allegations are that the company didn't have this AI tool that was able to match people.

Now again, they also had other issues - allegations that they forged signatures on documents and basically created a client base when they didn't really have any clients; they just lied to potential investors that they had all these clients. So, there's some other bad actions, but they also have this set of allegations about how they are using their AI or their purported AI tools.

So I think that's something that crypto companies really need to, really any companies for that matter, be cognizant of are any claims that involve the use of AI and I think there's a difference between like puffery or just self-promotional things or aspirational, versus, hey, this is what we are actually doing now and this is how it's a differentiator and this is why you should invest with us, or engage with us, is because we are better than our competitors and better than other companies because we're using this AI feature when that AI feature is not there. Like you can certainly say we're planning to use, or this is where we're working towards but I think you have to be very clear that if you're not there, don't suggest that you're there and using that tool already because that's certainly what SEC is focusing on.

Frank

Yeah, no, makes good sense. I mean, what's interesting for crypto companies is right now many of them are engaged in this existential debate with the SEC to clarify that they are not SEC registrants because a lot of them are decentralized organizations that cannot make disclosures about the operation of their business the way a typical publicly traded company might but there are also, I think, increasingly going to be companies that leverage crypto or blockchain technology that are publicly traded and that are SEC registered, that will have these kinds of disclosures about their technology, whether it's AI or blockchain or something altogether new that's coming down the pike and the fact that the SEC seems sort of to be policing it so aggressively is definitely concerning because I think in describing what technology you're using or how it works or what it does or why it's good or bad, some of that can get pretty heady and pretty opaque for many non tech oriented people. So it does sound like you have to have a special care and maybe the right sort of attorney lens applied to, you know, what can you say to investors and to the public about “product X” or “technology Y”.

Nick

Yeah. I think also with AI and with a lot of the more advanced tools, as you said, it gets really complex and I think how AI tools, especially if it's a generative AI tool and there's some type of a process, you may not know how you're getting certain responses or certain output. So I think just focusing on, well, this is what we hope or expect our tool to do, that's when you have to be very careful because again, you know, and that's going to be what's going to probably be most interesting for companies to use because nobody wants to read about the all, how things work and the architecture of all these dense tools. So just be mindful of that.

My takeaway on this part, be mindful of how any type of claims you're making about your AI tool, especially in these early years when there's, as I said, a lot of attention and a lot of focus by the government on AI stuff; just be mindful of what you're saying.

Frank

My other takeaway from what you're saying is that "AI-washing" is a term that needs to either stop or be explained better.

Nick

Is there another term? I'm trying to think of what would be better than AI-washing because you type in AI washing and only the SEC comes up with making comments about AI or someone commenting on what the SEC is talking about.

Frank

I mean, again, for me, it just, it conjures up Haley Joel Osment's character from AI, running some sort of AI driven, like, power washing or cleaning company.

Nick

Yeah, or, or, maybe the AI Haley Joel Osment, bathing, I don't know. Swimming in the pool? I don't know. What is this? Because he was the kid, right?

Frank

He was he was the kid. Yeah.

Nick

Replaced another kid, I guess, who died prematurely or -

Frank

Wow. You know much more than I do.

Nick

It's all coming back now that we're talking about it, I'm like, oh, maybe I should watch that movie again. I love the Jude Law scenes. The uncanny valley.

Frank

It's three hours of your life.

Nick

That was the - didn't they kind of try to touch him up a little bit, but you're right, three hours of my life.

Frank

Well hopefully we'll hit the third topic and we probably, hopefully, will not bring up Haley Joel Osment again, but I can't make any guarantees. So, the third thing I think you wanted to touch on was related to mining.

Nick

Yeah, the mining, and that's just, we've seen a couple and we've heard about mining companies that have traditionally mine Bitcoin or other cryptocurrencies that are now transitioning to being AI data centers and, it turns out, everything that AI needs - you know, a lot of computing power - is something that miners have. They have already the technology and the space and it's actually going to be pretty easy for them to, if they want to, switch from mining some type of Bitcoin, or otherwise using the processing power for cryptocurrencies to just pivot and now start working with AI firms who need all that data processing to train AI models, to run AI models, and so we're seeing some, right now I think it's mainly Bitcoin miners make, strike deals with AI companies and I think there may be, moving forward, a tension between the crypto companies and the AI companies as they compete for this processing power that miners are already in position and able to provide.

Frank

Yeah, I mean, Josh and I did an amicus brief for a trade association called the Satoshi Action Fund, and they are aggressively pushing model legislation, state legislation around the 50 states to try to best accommodate mining and I haven't talked to them about this, but I wonder the extent to which, sort of anyone has thought, does this legislation have some potential application to AI or is it somehow going to have to accommodate AI given this convergence of AI and miners in the crypto space? So definitely interesting and something that I think will maybe tie together those two worlds in a very concrete way pretty soon, I imagine.

Nick

Yeah. I mean, maybe you can even envision miners developing their own sort of AI models or AI platforms and not relying on third parties and, you know, getting into the AI space that way. So, I think a lot more to be seen on this front and how they play off each other.

Frank

Fascinating. Cool. Well, Nick, this is really, really interesting. I really enjoyed talking about AI, which is something I definitely do not know as much as you about and hopefully, you learned a thing or two about crypto, but thank you for coming on the podcast.

Any parting words for our listeners?

Nick

Yeah, maybe if you haven't seen it in a while, the Steven Spielberg epic AI is worth another visit.

Frank

It's a, it's a twist of the knife to my heart as a Stanley Kubrick fan but there you heard it folks. Go see the, I think it's a 2001 movie, Artificial Intelligence.

Nick

Ahead of its time, frankly.

Frank

Indeed. Haley Joel Osment was ahead of his time. And with that, thank you for listening to another episode of the CryptoCounsel at Wiley podcast.