BUILDING BLOCKS

Recent U.S. Regulatory And Legal Developments In Digital Currency + Blockchain

GOODWIN

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INTRODUCTION

2019 was a year of significant regulatory and legal developments in digital currency + blockchain. The United States Securities and Exchange Commission (the "SEC") issued its most comprehensive guidance to date with its Framework for "Investment Contract" Analysis of Digital Assets, followed that up with three "no action" letters for projects that in its view complied with the federal securities laws, and intensified its focus on initial coin offerings ("ICOs") conducted in 2017 and 2018 with a series of settlements and enforcement actions. The United States Department of Justice ("DOJ") brought criminal charges for fraud and money laundering in connection with sales of digital currencies. New York state regulators were active in regulating cryptocurrency exchanges and issuers through enforcement actions and licensing determinations. Courts continued to consider whether digital assets are securities under federal and state securities laws. Specifically:

SEC Guidance

Although the SEC's Framework for 'Investment Contract' Analysis of Digital Assets is not a binding rule, regulation, or statement of the SEC, it is the most comprehensive guidance issued by the SEC to date as to whether a digital asset falls within existing securities laws and is likely to be considered a security. As the Framework makes clear, the SEC's determination will depend on the facts and circumstances of each case – not a bright-line rule.

SEC "No Action" Letters

The SEC issued three "no action" letters in which the SEC staff determined that projects involving digital assets complied with the federal securities laws. While those "no action" letters depended on the specific facts of each project, they identified common factors, including (1) that the platform was fully developed and operational at the time that any tokens were sold, (2) that any tokens were able to be used for their intended purpose at the time that they were sold, (3) that any tokens were not transferable for sale on the secondary market, and (4) that any tokens were marketed in a manner that emphasized their functionality rather than their potential for increase in market value.

SEC Qualification of First Digital Token Offerings under Regulation A+

While there have been other offerings submitted to the SEC for approval, some through the Form S-1 path traditionally used by IPO issuers, the SEC qualified the offering statements of the first-ever offerings of digital tokens under Regulation A (Tier II), what is commonly referred to as "Regulation A+." Regulation A+ is sometimes referred to as a "mini-IPO" because it allows companies to raise up to $50 million in any rolling 12-month period and is not limited only to accredited investors, but the company must file periodic disclosures with the SEC that are similar to (but less onerous than) those for public companies.

SEC Settlements

The SEC settled five investigations, four of which concerned ICOs conducted in 2017 and 2018. While those settlements also depended on the specific facts of each project, they also identified common elements, including (1) registration as a class of securities; (2) a notice and claims process by which purchasers of tokens might request a refund, and (3) a monetary penalty. The SEC did not require all elements in all settlements, however, suggesting that there may be room for negotiation.

SEC Enforcement Actions

The SEC actively prosecuted seven enforcement actions, all of which concerned ICOs conducted in 2017 and 2018. That enforcement activity shows that the SEC is prosecuting not only cases that involve allegations of fraud but also cases that do not – with actions against Kik Interactive and Telegram Group headlining the latter category. In its cases against Kik and Telegram, the SEC has focused on (among other things): (1) the defendants' marketing of tokens as an investment opportunity; (2) the defendants' emphasis on their experience and resources as key to establishing and increasing the value of the tokens; (3) the defendants' claims that there would be a trading market for the tokens; and (4) the lack of a use for the tokens at the time of the ICO other than as an investment vehicle.

Criminal Cases

The DOJ brought two criminal cases involving charges of fraud and/or money laundering against a founder and a lawyer, respectively, of digital currency companies in connection with sales of tokens. Those cases centered on the allegedly criminal conduct of the defendants with the tokens simply a vehicle for that conduct.

State Regulatory Actions

New York regulators actively enforced statutes and regulations governing cryptocurrencies. The New York Attorney General filed a complaint against Bitfinex (one of the world's largest cryptocurrency exchanges) and Tether (the issuer of a "stablecoin" cryptocurrency backed by real world fiat currencies) for violations of New York's securities law, asserting broad jurisdiction over the conduct of exchanges and issuers that affects New York. At the same time, the New York Department of Financial Services denied a license to engage in virtual currency business activity to Bittrex (another of the world's largest cryptocurrency exchanges).

Private Litigation

In at least four cases, courts ruled that tokens issued as part of ICOs in 2017 and 2018 were securities under federal and state securities laws. In no cases did they rule that tokens were not securities.

In our inaugural review of U.S. regulatory and legal developments in digital currency + blockchain, we look at each of those developments in 2019 in more detail. 2020 is already off to a busy start, and we will provide an update on developments this year in a future publication.

SEC GUIDANCE

SEC "NO ACTION" LETTERS

Framework for "Investment Contract" Analysis of Digital Assets

On April 3, 2019, the SEC released the Framework for 'Investment Contract' Analysis of Digital Assets (the "Framework"). The Framework outlines the applicable standard for analyzing digital assets under the securities laws by applying the "investment contract" test articulated in *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293 (1946), to digital assets: (1) whether there is an investment of money, (2) whether there is a common enterprise, and (3) whether there is a reasonable expectation of profits to be derived from the efforts of others.

The Framework presents the SEC's view that the first two prongs are typically satisfied for digital assets and focuses on the third prong, which the SEC separates into two elements: (1) whether purchasers are reliant on the managerial efforts of others and (2) whether purchasers are led to expect profits from such efforts.

- Managerial Efforts of Others
  The Framework provides an illustrative list of factors that may suggest that purchasers are relying on the managerial efforts of others, including whether there is an expectation that other parties – including sponsors, promoters, and other third-parties – perform the following activities for the benefit of the digital asset or network: (1) develop or maintain the functionality of the network; (2) attain growth in the value of the digital asset; (3) take steps to support a market price by limiting supply or forcing scarcity (*e.g.*, through buybacks or "burning"); and/or (4) exercise continuing managerial oversight of the digital asset or network.
- Expectation of Profits
  The Framework also provides an illustrative list of factors that may suggest that purchasers have a reasonable expectation of profits, including where: (1) purchasers share in the capital appreciation of the digital asset; (2) the digital asset can be traded on the secondary market; (3) the digital asset is sold to purchasers who are not likely to use the asset for anything other than investment purposes; (4) the digital asset is marketed or promoted as an investment; (5) proceeds from the sale of the digital asset are used to increase the value of the digital asset or functionality of the network; and/or (6) the digital asset bears little correlation to the value of goods or services for which the digital asset can be exchanged.

In addition, the Framework presents a list of factors that, if satisfied, make it less likely that a digital asset will be considered an investment contract under *S.E.C. v. W.J. Howey Co.*. Those factors focus largely on purchasers' ability to use a digital asset for consumer or commercial purposes (as opposed to primarily as an investment). For example, the Framework provides the following illustrative list of factors that may indicate that a digital asset is less likely to be considered a security: (1) the network or platform is fully developed and operational; (2) the digital asset was designed for use rather than investment; (3) the potential for appreciation of the digital asset is limited; (4) trading or transfer of the digital asset is restricted; (5) the digital asset can be used as a payment tool for goods or services; and/or (6) any appreciation in value of the digital asset is incidental to its intended use. The Framework notes, however, that partial functionality, an expectation that a network will grow substantially, or an expectation that digital assets will appreciate in value may lead to the conclusion that even a functional token is a security.

TurnKey Jet, Inc., SEC No-Action Letter (April 3, 2019)

On April 3, 2019, the same day that it published the Framework, the SEC also issued its first no-action letter in connection with a token sale to TurnKey Jet, Inc. ("TurnKey Jet"). TurnKey Jet, a licensed U.S. air carrier and air taxi operator providing interstate air charter services, proposed to offer and sell digital assets in the form of "tokenized" jet cards ("Cards"). Consumers of air charter services would be able to use the Cards to purchase services from TurnKey Jet, third-party carriers, and brokers of charter flights. In its no-action letter, the SEC staff confirmed that it would not recommend enforcement action if TurnKey Jet sold the Cards without registration under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act").

The SEC staff identified the following factors as supporting its decision to grant no-action relief: (1) TurnKey Jet would not use any funds from sales of Cards to develop its platform, network, or app, each of which would be fully developed and operational at the time any Cards were sold; (2) the Cards would be able to be used for their intended functionality at the time that they were sold; (3) TurnKey Jet would restrict transfers of Cards to only TurnKey Jet wallets (and not to external wallets); (4) TurnKey Jet would sell Cards at a price of US $1 per Card throughout the life of the program, and each Card would represent a TurnKey Jet obligation to supply air charter services at a value of US $1 per Card; (5) if TurnKey Jet offered to repurchase Cards, it would do so only at a discount to the face value of the tokens (US $1 per Card) unless a U.S. court ordered TurnKey Jet to liquidate the Cards; and (6) the Cards would be marketed in a manner that emphasized the functionality of the Cards, not the potential for an increase in market value of the Cards.

The no-action letter specified that the SEC staff's position was based on the representations in Turnkey Jet's letter concerning the facts underlying its proposal and that any different facts might require the SEC staff to re-evaluate the application of the securities laws to the proposal and potentially reach a different conclusion.

Pocketful of Quarters, SEC No-Action Letter (July 25, 2019)

On July 25, 2019, the SEC issued its second no-action letter in connection with a token sale to Pocketful of Quarters. Pocketful of Quarters is a company founded to address "fragmentation" of in-game credits and currencies in the video game industry through a centralized platform built with blockchain technology. That "fragmentation" results from "siloed video game economies" in which the credits used by players to access exclusive features – whether purchased or earned by playing the game – can be used only within the specific game in which they were purchased or earned. Pocketful of Quarters' mission is to improve players' experiences by creating a "universal gaming token" called Quarters that functions as an in-game currency that can be freely used in and transferred among many participating games, as well as e-sports competitions hosted by Pocketful of Quarters. In its no-action letter, the SEC staff confirmed that it would not recommend enforcement action if Pocketful of Quarters sold the Quarters without registration under the Securities Act and the Exchange Act.

The SEC staff identified the following factors as supporting its decision to grant no-action relief: (1) Pocketful of Quarters would not use proceeds from the sale of Quarters to build the Quarters platform, which already had been fully developed and would be fully operational prior to the sale of any Quarters; (2) the Quarters would be able to be used for their intended purpose at the time that they were sold; (3) Pocketful of Quarters would implement various technological and contractual provisions governing Quarters and the Quarters platform that restricted the transfer of Quarters; (4) users would be able to transfer Quarters from their own "wallets" only to developers with approved accounts or to Pocketful of Quarters in connection with e-sports tournaments; (5) only developers and influencers with approved accounts would be capable of exchanging Quarters for ether at a pre-determined exchange rate and approved accounts would be subject to initial and on-going KYC/AML checks; (6) Quarters would be made continuously available in unlimited quantities at a fixed price; (7) there would be a correlation between the purchase price of Quarters and the market price of accessing the relevant features of participating games; and (8) Pocketful of Quarters would market and sell Quarters only for consumptive use within participating games.

The no-action letter again specified that the SEC staff's position was based on the representations in Pocketful of Quarters' letter concerning the facts underlying its proposal and that any different facts might require the SEC staff to re-evaluate the application of the securities laws to the proposal and potentially reach a different conclusion.

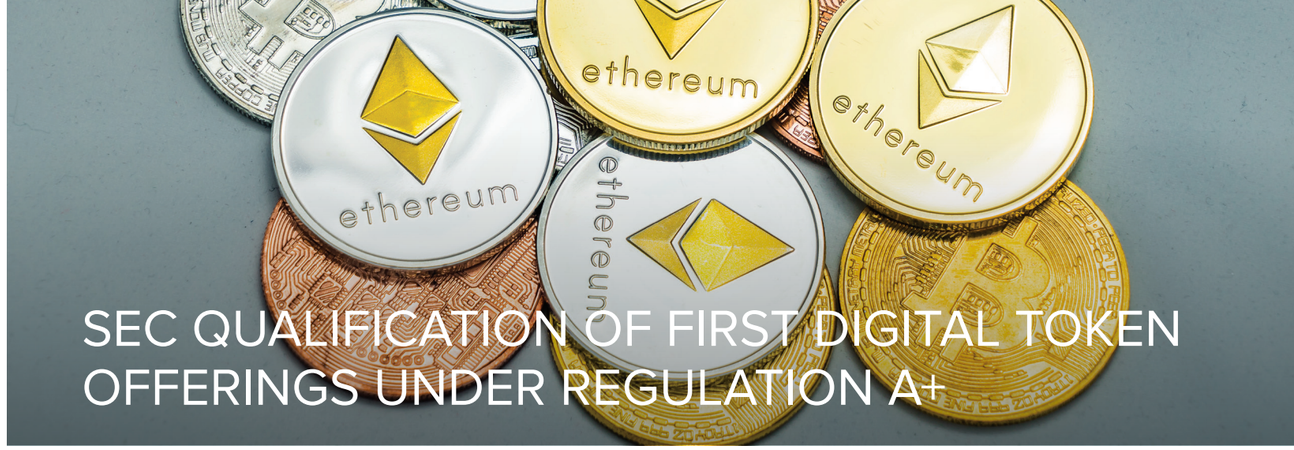
Paxos Trust Company, LLC, SEC No-Action Letter (Oct. 28, 2019)

On October 28, 2019, the SEC issued a no-action letter to Paxos Trust Company in connection with its proposal to settle equity securities trades on a blockchain platform for broker-dealers. The proposed "Paxos Settlement Service" is a private and permissioned distributed ledger system that records changes in the ownership of securities and cash resulting from the settlement of securities transactions between participants. Paxos described the benefits of providing such services on the blockchain as the facilitation of more efficient settlement, immediate access to the settlement proceeds, greater data accuracy and transparency, advanced security, and increased levels of availability and operational efficiency. To evaluate those benefits, Paxos requested no-action relief for 24 months to operate the Paxos Settlement Service in a production environment for the clearance and settlement of trades of listed U.S. equity securities trades without registering as a clearing agency. In its no-action letter, the SEC staff confirmed that it would not recommend enforcement action if Paxos operated the Paxos Settlement Service without registering as a clearing agency.

Paxos requested no-action relief for 24 months to operate the Paxos Settlement Service in a production environment for the clearance and settlement of trades of listed U.S. equity securities trades without registering as a clearing agency.

The SEC staff identified the following factors as supporting its decision to grant no-action relief: (1) the Feasibility Study No-Action Phase will be conducted in a "de minimis" manner with "well-defined" parameters and limits of volume of shares settled; (2) Paxos will establish and implement procedures reasonably designed to maintain ongoing compliance; (3) Paxos will provide the SEC with prior or same-day notifications of certain events specified in its proposal for the duration of the Feasibility Study No-Action Phase; and (4) Paxos will wind down the Feasability Study No-Action Phase during the twenty-third month.

Following the grant of no-action relief, Paxos announced that Credit Suisse and Société Générale would be the first two companies to use the Paxos Settlement Service.



SEC QUALIFICATION OF FIRST DIGITAL TOKEN OFFERINGS UNDER REGULATION A+

Blockstack PBC (File No. 024-11033)

On July 10, 2019, the SEC qualified the first-ever offering of digital tokens under Regulation A+. Blockstack PBC sought to offer up to 180,333,333 "Stacks Tokens" in the following ways: (1) 78,333,333 Stacks Tokens at a discounted price of US $0.12 per token (up to a maximum of US $3,000 per holder) to current holders of certain non-binding vouchers to purchase Stacks Tokens, (2) 62,000,000 Stacks Tokens at a price of US $0.30 per token to "qualified purchasers" as defined under Regulation A+, and (3) up to 40,000,000 Stacks Tokens for non-cash consideration pursuant to Blockstack's "App Mining" program in exchange for the development and review of applications on Blockstack's decentralized application network. (Blockstack PBC had previously filed a preliminary offering statement under its subsidiary, Blockstack Token LLC, on April 11, 2019 (File No. 024-10986), which was subsequently withdrawn after Blockstack PBC was to act as issuer of the Stacks Tokens.) "Qualified purchasers" under Regulation A include accredited investors as well as unaccredited investors who may invest only up to a maximum of 10 percent of the greater of their annual income or net worth.

The offering circular that was included as part of the offering statement noted that Stacks Tokens are the native token of the Blockstack network, meaning that they are used as the default currency to obtain control over digital assets on the Blockstack network. The Blockstack network is intended to be an open-source, peer-to-peer network using blockchain technologies ultimately to build a new network that will enable and encourage the creation and use of decentralized applications.

The offering circular noted that possession of Stacks Tokens will allow users to perform certain actions on the Blockstack network, including burning the tokens as "fuel" to create a new digital asset or smart contract, paying application developers to download or access their applications, and making in-application payments for digital assets to application developers as well as other users. The offering circular also noted that Stacks Token holders may be permitted to participate in non-binding polling regarding potential upgrades to the network and that Blockstack may use Stacks Tokens to provide incentives to users, developers, and employees (including through the App Mining program). In addition, the offering circular noted that, while Stacks Tokens are freely tradable on registered exchanges or alternative trading systems, no exchanges or trading systems currently exist to support the trading of Stacks Tokens on the secondary market.

The offering circular noted that Blockstack is treating the Stacks Tokens as securities based on its view that the tokens are "investment contracts" under the SEC's Framework (as summarized above) and the application of *SEC v. W.J. Howey Co.* to digital assets. Although the offering relies on Regulation A+ as an exemption from federal registration under the Securities Act, Blockstack has taken the position that the commercial uses of Stacks Tokens on the Blockstack network (including transfer between users) do not require registration or an exemption from registration under state securities laws. The offering circular also noted that Blockstack has taken the position that registration as a transfer agent, clearing agency, exchange or alternative trading system, or broker-dealer is not required under the Exchange Act with respect to Blockstack, the network's blockchain, the network, and/or its miners. In addition,

the offering circular noted that Blockstack may in the future determine that Stacks Tokens no longer constitute securities under federal and state securities laws if the network is sufficiently decentralized, purchasers of Stacks Tokens do not reasonably expect Blockstack to carry out essential or managerial efforts, and Blockstack does not retain a degree of power over the governance of the network such that any material, non-public information about Blockstack would be of special relevance to the network.

YouNow, Inc (File No. 024-11018)

On July 11, 2019, one day after the qualification of Blockstack's offering, the SEC qualified the second offering of digital tokens under Regulation A+. YouNow, Inc. sought to offer an aggregate of 178,000,000 "Props Tokens" at a deemed price of $0.1369 per token in (1) a primary distribution of up to 133,000,000 Props Tokens as a reward to users of its applications for in-application activities (such as contributing content and attention to those apps), a one-time discretionary grant to users of its Props Live Video App, or a reward to administrators of its own Props blockchain that it is building and (2) a secondary distribution of up to 45,000,000 Props Tokens by its wholly-owned subsidiary, The Props Foundation Public Benefit Corporation ("Props PBC"), which will grant tokens to developers of key applications and those who otherwise contribute to network development efforts. All Props Tokens will be issued in exchange for non-cash consideration and, therefore, neither YouNow nor Props PBC will receive any cash proceeds from the offering.

The offering circular described Props Tokens as Ethereum-based and "ERC-20" compliant cryptographic tokens, which means that they are digital assets existing on the Ethereum blockchain and that the rules governing Ethereum-based smart contracts that create Props Tokens adhere to widely known "ERC-20" conventions. Holders of Props Tokens will have the ability to access premium, built-in functionality through YouNow's network of consumer-facing digital media applications (the "Props Apps"), which may include application-specific key features available only to Props Token holders, the ability to send tokens to other users, voting on potential changes to Props Apps, and elevated status in the Props Apps network. At the time of the offering, only one Props App was ready to be connected to the Props Apps network.

Although only "qualified purchasers" (as described above in the Blockstack summary) may purchase securities under Regulation A, the offering circular noted that YouNow has deemed this limitation not to apply to non-cash consideration and, therefore, no limits will apply to the issuance of Prop Tokens under YouNow's app rewards or validator rewards programs or Props PBC's grant program. Recipients of Props Tokens must complete certain administrative steps in order to receive Props Tokens pursuant to the offering, including KYC/AML checks and the completion of other required documents.

The offering circular noted that, while Props Tokens are freely tradable on registered exchanges or alternative trading systems, no exchanges or trading systems currently exist to support the trading of Props Tokens on the secondary market. The offering circular also noted that YouNow is treating Props Tokens as securities based on its view that the tokens are "investment contracts" under the SEC's Framework (as summarized above) and the application of *SEC v. W.J. Howey Co.* to digital assets. Although the offering relies on Regulation A+ as an exemption from federal registration under the Securities Act, YouNow has limited its offering such that residents of certain states (*i.e.*, Arizona, Nebraska, North Dakota, and Texas) will not be allowed to participate in the offering. In addition, the offering circular noted that YouNow has taken the position that registration as a transfer agent, clearing agency, exchange or alternative trading system, or broker-dealer is not required under the Exchange Act with respect to YouNow, Props PBC, the Ethereum blockchain, the Props blockchain, the validators of such blockchains, the network, and/or the Props Apps. The offering circular further noted that YouNow may in the future determine that Props Tokens no longer constitute securities under federal and state securities laws if the network is sufficiently decentralized such that purchasers of Props Tokens do not reasonably expect YouNow to carry out essential or managerial efforts.

SEC SETTLEMENTS

Gladius Network LLC, Securities Act Release No. 10608 (Feb. 20, 2019)

On February 20, 2019, the SEC issued an order instituting cease-and-desist proceedings pursuant to Section 8A of the Securities Act, making findings, and imposing a cease-and-desist order with respect to Gladius Network LLC ("Gladius") in connection with an ICO allegedly conducted in violation of Sections 5(a) and 5(c) of the Securities Act. The order was part of a settlement between Gladius and the SEC.

The Gladius Network was established as a decentralized, peer-to-peer node network offering internet content providers faced with a DDoS attack or increased traffic the ability to access spare bandwidth and storage space belonging to organized "pools" of individuals and businesses (called "nodes"). In late 2017, Gladius conducted an ICO of its "GLA Token" and raised proceeds worth approximately US $12.7 million. The objective of Gladius' token sale was to raise the funds needed to continue developing Gladius' network and corporate infrastructure. GLA Tokens could thereafter be acquired directly from Gladius or purchased (and sold) on secondary markets.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC determined that the GLA Tokens were securities and that the sale of GLA Tokens was an unregistered securities offering because a purchaser of GLA tokens would have had a reasonable expectation of obtaining future profits from the growth of the Gladius Network based on the efforts of Gladius' employees and agents – regardless of whether that purchaser used the Gladius Network. The SEC required Gladius to: (1) cease and desist from further violations; (2) register the GLA Tokens under Section 12(g) of the Exchange Act as a class of securities; and (3) establish a notice and claims process by which purchasers of the GLA Tokens through the ICO may request a refund. As a result of Gladius' self-reporting, cooperation with the SEC investigation, and "prompt remedial steps" in response to the SEC's concerns, the SEC did not impose a monetary penalty. Gladius did not admit or deny the SEC's findings.

Gladius originally was required to file its registration statement by May 20, 2019. That deadline was extended to November 18, 2019. Gladius announced on November 25, 2019, that it was ceasing business operations effective immediately because it no longer had funds to continue.

SimplyVital Health Inc., Securities Act Release No. 10671 (Aug. 12, 2019)

On August 12, 2019, the SEC issued an order instituting cease-and-desist proceedings pursuant to Section 8A of the Securities Act, making findings, and imposing a cease-and-desist order with respect to SimplyVital Health, Inc. ("SimplyVital") in connection with token sales allegedly conducted in violation of Sections 5(a) and 5(c) of the Securities Act. The order was part of a settlement between SimplyVital and the SEC.

SimplyVital is the creator of Health Nexus, "a health care-related blockchain ecosystem" through which healthcare providers can share patient data. In late 2017, SimplyVital announced its intention to conduct an ICO to raise capital for further development of HealthNexus. From September 2017 through April 2018, SimplyVital raised approximately US $6.3 million through a "presale" of its token called "Health Cash," which investors purchased through Simple Agreements for Future Tokens ("SAFTs"). SimplyVital stated that, in

conducting the presale, it was relying on the exemption provided by Section 4(A)(2) of the Securities Act and Regulation D and/or the safe harbor provided by Regulation S for offers and sales that occur outside of the United States.

The SEC determined that the presale of Health Cash was an unregistered securities offering that was not subject to any exemption or safe harbor because (among other things): (1) SimplyVital was aware that a number of purchasers were pooling funds from various unknown individuals for the purpose of participating in the presale and made no efforts to determine the accredited investor status of those individuals and (2) SimplyVital permitted certain non-U.S. investors, who provided the majority of the proceeds of the presale, to purchase securities without undertaking any accredited investor verification.

The SEC contacted SimplyVital and provided its views before SimplyVital issued any tokens. In response, SimplyVital voluntarily returned the proceeds of the presale. Although the SEC required SimplyVital to cease and desist from further violations, the SEC did not impose a monetary penalty. SimplyVital did not admit or deny the SEC's findings.

Block.one, Securities Act Release No. 10714 (Sept. 30, 2019)

On September 30, 2019, the SEC issued an order instituting cease-and-desist proceedings pursuant to Section 8A of the Securities Act, making findings, and imposing a cease-and-desist order with respect to Block.one in connection with an ICO allegedly conducted in violation of Sections 5(a) and 5(c) of the Securities Act. The order was part of a settlement between Block.one and the SEC.

Block.one is a technology company that was founded in 2016 to develop the EOSIO software, which was designed to support public and private blockchains by increasing blockchain transaction speeds, reducing transaction costs, and improving blockchain scalability. From June 26, 2017, through June 1, 2018, Block.one conducted an ICO during which it sold 900 million ERC-20 tokens and raised proceeds worth approximately US $4 billion.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC determined that the ERC-20 tokens were securities and that the sale of those tokens was an unregistered securities offering because a purchaser of the tokens would have a reasonable expectation of profit based on Block.one's efforts in developing, promoting, and launching its software and blockchains. The SEC required Block.one to cease and desist from further violations and to pay a monetary penalty of US $24 million. Block.one did not admit or deny the SEC's findings.

The SEC required Block.one to cease and desist from further violations and to pay a monetary penalty of US $24 million.

XBT Corp. SARL, d/b/a First Global Credit, Securities Act Release No. 10723, Securities Exchange Act Release No. 87428 (October 31, 2019)

On October 31, 2019, the SEC issued an order instituting cease-and-desist proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, making findings, and imposing a cease-and-desist order with respect to XBT Corp. SARL ("XBT") in connection with its alleged actions as an unregistered dealer in offering and selling security-based swaps in violation of Section 5(e) of the Securities Act and Sections 6(1) and 15(a) of the Exchange Act. The order was part of a settlement between XBT and the SEC.

XBT is a Swiss company that allowed its customers to invest in the stock market using cryptocurrencies without first exchanging those cryptocurrencies for fiat. From 2014 to 2019, XBT offered and sold security-based swaps to its customers through its website. XBT was not registered with the SEC while offering and selling those security-based swaps to U.S. investors. XBT also did not inquire into, or require investors to meet, certain asset or income thresholds before engaging in the swaps.

The SEC determined that XBT violated Section 5(e) of the Securities Act and Section 6(1) of the Exchange Act because the swaps were not executed with eligible contract participants, XBT did not act with an effective registration statement, and the swaps were not effected on a national securities exchange. The SEC determined that XBT violated Section 15(a) of the Exchange Act because it acted as an unregistered dealer in offering and selling the swaps. The SEC required XBT to (1) cease and desist from violating the Securities Act and the Exchange Act and (2) pay approximately US $132,000 in disgorgement, prejudgment interest, and a monetary penalty. XBT did not admit or deny the SEC's findings.

In the Matter of Blockchain of Things, Inc., Securities Act Release No. 19621 (Dec. 18, 2019)

On December 18, 2019, the SEC issued an order instituting cease-and-desist proceedings pursuant to Section 8A of the Securities Act, making findings, and imposing penalties and a cease-and-desist order with respect to Blockchain of Things Inc. (BCOT) in connection with an ICO allegedly conducted in violation of Sections 5(a) and 5(c) of the Securities Act. The order was part of a settlement between BCOT and the SEC.

BCOT is a blockchain technology company seeking to develop a blockchain-based technology and platform that are intended to allow third-party developers to build applications for message transmission and logging, digital asset generation, and digital asset transfer. From December 2017 through July 2018, BCOT conducted an ICO and raised proceeds worth approximately US $13 million.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC determined that the BCOT tokens were securities and that the sale of those tokens was an unregistered securities offering because: (1) BCOT's ecosystem was not developed at the time of the offering, functioning only in a "beta" or pilot phase; (2) the price of the tokens increased as more tokens were sold over time; (3) the tokens were convertible into "credits" and also freely transferrable on the secondary market; and (4) purchasers reasonably viewed the token offering as an opportunity to profit if the ecosystem was successful. In addition, the SEC determined that BCOT sold its tokens to U.S. investors without qualifying for an exemption to the registration requirements and engaged four "resellers" to sell its tokens in certain foreign countries without any restriction on the resale of those tokens to U.S. investors.

The SEC required BCOT to: (1) cease and desist from further violations; (2) register its tokens under Section 12(g) of the Exchange Act as a class of securities; (3) establish a notice and claims process by which purchasers of the tokens through the ICO may request a refund; and (4) pay a monetary penalty of US $250,000.

The SEC required BCOT to: (1) cease and desist from further violations; (2) register its tokens under Section 12(g) of the Exchange Act as a class of securities; (3) establish a notice and claims process by which purchasers of the tokens through the ICO may request a refund; and (4) pay a monetary penalty of US $250,000. BCOT did not admit or deny the SEC's findings.

SEC ENFORCEMENT ACTIONS

Securities and Exchange Commission v. Blockvest, LLC, No. 18CV2287-GPB(BLM), 2019 WL 625163 (S.D. Cal. Feb. 14, 2019)

On February 14, 2019, the U.S. District Court for the Southern District of California entered a preliminary injunction prohibiting Blockvest, LLC ("Blockvest") and its founder (Reginald Buddy Ringgold, III) from violating Section 17(a) of the Securities Act. The decision came after the court initially denied the SEC's motion last November seeking a preliminary injunction freezing Blockvest's assets and barring it from proceeding with a planned ICO and any other securities sales.

Blockvest, a company formed to exchange cryptocurrencies, and its founder allegedly offered and sold tokens called "BLVs" through Blockvest's website, whitepaper, and social media accounts. Blockvest and its founder allegedly falsely represented that the ICO had been approved by the SEC, the Commodity Futures Trading Commission, and the National Futures Association. Blockvest and its founder also allegedly promoted the ICO using a fictitious regulatory agency – the "Blockchain Exchange Commission" – with a seal similar to the SEC's and the same address as the SEC's headquarters.

In entering a preliminary injunction, the court found that Blockvest's promotional materials constituted an offer of unregistered securities. Applying the test set forth in *SEC v. W.J. Howey Co.*, the court concluded that BLVs were securities because Blockvest's website and whitepaper urged people to pay for the tokens with digital or other currency, provided that any funds raised would be pooled together and later divided among investors using a profit sharing formula, and described purchases of BLVs as "passive" investments that would generate "passive income."

U.S. Securities and Exchange Commission v. Kik Interactive, Inc., No. 19-cv-5244 (S.D.N.Y. filed on June 4, 2019)

On June 4, 2019, the SEC filed an enforcement action in the U.S. District Court for the Southern District of New York against Kik Interactive, Inc. ("Kik") for violations of Sections 5(a) and 5(c) of the Securities Act for the sale of unregistered securities. The SEC seeks a permanent injunction, disgorgement of all "ill-gotten gains or unjust enrichment" (with pre-judgment interest), and a monetary penalty.

Kik is a company that owned and developed an online messaging platform called Kik Messenger. In late 2016 and early 2017, Kik's more traditional sources of investment and venture capital funding allegedly dwindled and Kik allegedly faced the prospect of running out of cash to fund operations by the end of 2017. Kik allegedly decided to "pivot" to an entirely new business – selling tokens called "Kin." Kik allegedly conducted an ICO in early 2017 in which it sold more than US $55 million worth of Kin. Including subsequent sales, Kik allegedly sold one trillion Kin and raised proceeds worth approximately US $100 million without registration under the Securities Act or the Exchange Act. At the time of filing, Kin allegedly traded on unregulated trading platforms at approximately half of the ICO value.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC alleged that Kin were unregistered securities because: (1) Kik marketed Kin as an investment opportunity; (2) Kik promised to increase Kin's price through its efforts; (3) Kik repeatedly emphasized its own experience and resources as key to establishing and increasing Kin's value; and (4) a Kik consultant warned that the "Kin offering" was potentially an offering of securities that required registration with the SEC.

The SEC alleged that Kin were unregistered securities because: (1) Kik marketed Kin as an investment opportunity; (2) Kik promised to increase Kin's price through its efforts; (3) Kik repeatedly emphasized its own experience and resources as key to establishing and increasing Kin's value; and (4) a Kik consultant warned that the "Kin offering" was potentially an offering of securities that required registration with the SEC.

Kik filed its answer to the SEC's complaint on August 7, 2019. Kik stated that the complaint "badly mischaracterizes the totality of the facts and circumstances leading up to Kik's sale of Kin" and "reflects a consistent effort to twist the facts by removing quotes from their context and misrepresenting the documents and testimony" produced to the SEC during its investigation. The parties have commenced discovery.

Securities and Exchange Commission v. Bitqyck, Inc., No. 3:19-cv-2059-N (N.D. TX)

On August 29, 2019, the SEC issued a final judgment as to Bitqyck Inc. ("Bitqyck") and its founders (Bruce Bise and Sam Mendez) concerning the defendants' conduct with respect to the sale of digital tokens and the failure to register as a national securities exchange. The order was part of a settlement between the defendants and the SEC.

Bitqyck's founders allegedly mass-marketed two tokens called "Bitqy" and "BitqyM" – both as standalone assets and as a "reward" alongside other products – to more than 13,000 investors located in 45 states and 20 countries. In total, those sales allegedly raised proceeds worth more than US $13 million for Bitqyck. Bitqyck also allegedly created and maintained TradeBQ.com, a continuously available online trading platform that permitted investors to post bids and offers in Bitqy to be exchanged for Bitcoin.

The SEC filed a complaint against Bitqyck and its founders, alleging that they sold unregistered securities in violation of Sections 5(a) and 5(c) of the Securities Act; made material misrepresentations in violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act; failed to register as a national securities exchange in violation of Section 5 of the Exchange Act; and aided and abetted the failure to register as a national securities exchange. The SEC sought (among other things) the return of all "ill-gotten gains" associated with the more than US $13 million in proceeds from the token sales, prejudgment interest, and a monetary penalty.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC alleged that "Bitqy" and "BitqyM" tokens were unregistered securities because: (1) investors paid money for the tokens; (2) investors' success was linked directly to Bitqyck's efforts in attracting new investors and operating a cryptocurrency mining facility; and (3) investors had a passive role in the project and an expectation that their investments would appreciate in value as a result of Bitqyck's efforts in operating its business and listing the tokens on exchanges.

The SEC also alleged that Bitqyck made material misrepresentations by (1) representing that purchasers of Bitqy tokens would automatically be issued 1/10 of a share of Bitqyck common stock for each token purchased through operation of a "smart contract" but failing to transfer any Bitqyck common stock to token purchasers, (2) representing that Bitqyck would drive the value of Bitqy tokens through its "QyckDeals" platform but in fact lacking the technological capability to create the "QyckDeals" platform, and (3) representing that Bitqyck owned a cryptocurrency mining facility (powered by electricity that it purchased at below-market rates) from which investors would receive the right to profit but in fact not owning such a facility.

In addition, the SEC alleged that the TradeBQ.com platform's functionality required Bitqyck to register as a national securities exchange but that Bitqyck had failed to do so, thereby violating the federal securities laws.

The final judgment entered as part of the settlement (1) enjoined the defendants from violating Sections 5 and 17(a) of the Securities Act and Sections 5 and 10(b) of the Exchange Act; (2) required the defendants to disgorge approximately US $8,375,617 in profits and pay approximately US $890,254 in prejudgment interest; and (3) required the defendants to pay a US $850,022 monetary penalty. Bitqyck and its founders did not admit or deny the SEC's allegations.

Securities and Exchange Commission v. ICOBox, No. 2:19-cv-08066-DSF (C.D. Cal. filed Sept. 18, 2019)

On September 18, 2019, the SEC filed an enforcement action in the U.S. District Court for the Central District of California against ICOBox and its co-founder and CEO (Nikolay Evdokimov) for violations of Sections 5(a) and 5(c) of the Securities Act for the sale of unregistered securities and for violations of Section 15(a) of the Exchange Act for acting as an unregistered broker for clients' token offerings. The SEC sought a permanent injunction barring future securities violations, disgorgement of all funds from the allegedly illegal conduct and prejudgment interest, and a monetary penalty.

ICOBox is a service provider "for companies seeking to sell their products via ICO/STO crowdsales." From August 9, 2017, through September 15, 2017, ICOBox allegedly sold approximately US $14.6 million worth of tokens called "ICOS." The primary selling point allegedly was that ICOS could be swapped for tokens issued by ICOBox's clients at a 75 percent discount on average.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC alleged that ICOS were unregistered securities because the defendants stated: (1) investors could profit from swapping their ICOS for tokens from future ICOs by ICOBox's clients at a discount and from trading ICOS on digital asset platforms and (2) ICOS success depended on ICOBox's co-founder and management.

In addition, the SEC alleged that ICOBox and its co-founder "provided unregistered broker services" and "act[ed] as unregistered brokers in connection with ICOBox's clients' token sales." The defendants allegedly facilitated token sales for over 30 clients. For each token sale, the defendants allegedly would help structure, promote, and solicit investors for, the ICO. If the ICO was a success, the defendants would charge the clients "success fees starting at 1.5% of the amount raised." At least one token sale (i.e., the sale for Paragon Coin, Inc.) allegedly constituted an unregistered securities offering.

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The court entered a default against the defendants on October 28, 2019, for failure to respond after a summons was served on them. The court subsequently filed an order to show cause demanding that the SEC file a motion for default judgment by or before January 10, 2020, or else face potential sanctions.

Securities and Exchange Commission v. Telegram Group Inc., No. 19 Civ. 9439 (S.D.N.Y. filed Oct. 11, 2019)

On October 11, 2019, the SEC filed an emergency action in the U.S. District Court for the Southern District of New York against Telegram Group Inc. and a wholly-owned subsidiary for violations of Sections 5(a) and 5(c) of the Securities Act for the sale of unregistered securities. The SEC sought and obtained a temporary restraining order to prevent Telegram from issuing tokens in an ongoing offering that had raised more than US $1.7 billion to date. In addition, the SEC sought a preliminary injunction barring distribution of Telegram's digital currency, disgorgement of ill-gotten gains with prejudgment interest, an order prohibiting defendants from participating in any offering of digital asset securities, and a monetary penalty.

Telegram is a company that owns and operates the mobile messaging application, Telegram Messenger. Between January and March 2018, Telegram allegedly conducted an ICO for its token called "Grams" to raise capital and finance its blockchain, the "Telegram Open Network" or "TON Blockchain." Telegram allegedly sold 2.9 billion "Grams" at discounted prices to 171 initial purchasers worldwide, including more than 1 billion Grams to 39 U.S. purchasers, and allegedly raised approximately US $1.7 billion. Telegram allegedly promised to deliver the Grams to the initial purchasers upon the launch of its blockchain by no later than October 31, 2019, and also allegedly planned on selling millions of additional Grams at that time. Purchasers and Telegram then allegedly would be able to sell the Grams in the United States.

The SEC alleges that Grams were unregistered securities because: (1) Telegram represented that it would pool the proceeds from the Grams to finance the company and develop additional products; (2) Telegram advertised the experience and skill of its employees in building the TON Blockchain; (3) Telegram claimed that there would be a trading market for Grams; and (4) there was no available use for the Grams at the time of the ICO other than as an investment vehicle.

Telegram filed an answer to the complaint on November 12, 2019, asserting a counterclaim that "the SEC has failed to provide consistent and meaningful guidance on whether and how it will regulate cryptocurrencies like Grams. Moreover, the SEC never provided fair notice that it believed Telegram's actions had violated and would violate the federal securities law, even as it knew Telegram was expending significant time and resources, including investor funds, to prepare to launch the TON Blockchain and Grams."

Securities and Exchange Commission v. Middleton, No. 1:19-cv-04625 (E.D.N.Y. filed Nov. 1, 2019)

On November 1, 2019, the SEC issued a final judgment as to Veritaseum, Inc., Veritaseum, LLC, and their founder (Reginald Middleton) concerning the defendants' conduct with respect to an ICO and the manipulation of cryptocurrency. The order was part of a settlement between the defendants and the SEC.

Reginald Middleton formed Veritaseum, Inc., in 2014 and Veritaseum, LLC, in 2017 to develop software that permitted "peer to peer exchanges of value" using a blockchain. From April 25, 2017, to May 26, 2017, the defendants conducted an ICO of tokens called "VERI Tokens," "VERI" or "Veritas." The defendants also engaged in post-ICO sales of VERI Tokens from May 26, 2017, to February 2018. In total, those sales raised proceeds worth approximately US $14.8 million.

The SEC alleged that the VERI Tokens were securities and that the sales of those tokens were unregistered securities offerings because the claimed functionality of the VERI Tokens did not exist at the time of the ICO. Rather, the defendants stated that the money paid for the tokens would be pooled into a common enterprise, which would generate profits based on the defendants' managerial expertise and efforts following the close of the ICO.

The SEC also alleged that the defendants made a series of material misrepresentations concerning Veritaseum, the use of the ICO proceeds, investor demand for VERI Tokens, and the existence of a market-ready product. In addition, the SEC alleged that Mr. Middleton misappropriated funds raised in the ICO for his own use and engaged in manipulative trades that artificially inflated the value of VERI Tokens. Specifically, one week after the ICO, Mr. Middleton allegedly misrepresented to investors that hackers had stolen 36,000 tokens with an approximate value of US $8 million.

When the SEC informed the defendants' counsel that it was going to take enforcement action, the defendants transferred and used more than US $2 million of the ICO proceeds the next day. The SEC then filed a complaint against the defendants, alleging that the defendants sold unregistered securities in violation of Sections 5(a) and 5(c) of the Securities Act; made

material misrepresentations concerning the ICO in violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act; and manipulated the value of VERI Tokens in violation of Section 9(a)(2) of the Exchange Act. The SEC sought a temporary restraining order that (among other things) froze all of the defendants' assets and appointed a third-party to escrow all of the defendants' digital assets.

The final judgment entered as part of the settlement (1) enjoined the defendants from violating Sections 5 and 17(a) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act; (2) barred Mr. Middleton from acting as a director or officer of any issuer registered with the SEC; (3) prohibited the defendants from engaging in any offering of digital securities; and (4) required the defendants to disgorge approximately US $7.9 million in profits and pay approximately US $580,000 in prejudgment interest and Mr. Middleton himself to pay a US $1 million monetary penalty. Those amounts were to be paid into a fair fund to compensate the victims of the defendants' fraud.

Securities and Exchange Commission v. Eyal and UnitedData, Inc. d/b/a "SHOPIN," No. 1:19-cv-11325 (S.D.N.Y. filed Dec. 11, 2019)

On December 11, 2019, the SEC filed an enforcement action in the United States District Court for the Southern District of New York against UnitedData, Inc. d/b/a Shopin ("Shopin") and its CEO (Eran Eyal) for violations of Sections 5(a) and 5(c) of the Securities Act for the sale of unregistered securities and violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder for material misrepresentations in connection with that sale. The SEC seeks a permanent injunction, an order barring Mr. Eyal from acting as a director or officer of any issuer registered with the SEC, an order prohibiting the defendants from engaging in any offering of digital securities, disgorgement of all "ill-gotten gains or unjust enrichment" (with pre-judgment interest), and a monetary penalty.

Shopin is a company with a mission to create a blockchain-powered "universal shopper profile" that would track customers' purchase histories and allow it to make future product recommendations based on those purchase histories. Shopin allegedly was struggling financially, however, and conducted an ICO to raise capital. From August 2017 through April 2018, Shopin allegedly conducted an ICO of tokens called "Shopin tokens" and raised proceeds worth at least US $42.5 million. The ICO allegedly was conducted in two stages: (1) a pre-sale of tokens to individuals and investment syndicates beginning in August 2017 and (2) an ICO from March through April 2018.

Applying the test set forth in *SEC v. W.J. Howey Co.*, the SEC alleges that Shopin tokens are unregistered securities because: (1) investors used digital currency to purchase Shopin tokens; (2) Shopin conveyed that investors' funds would be pooled in a common enterprise by providing specific digital wallet addresses where investor assets would be pooled and later transferred to Shopin digital wallets or bank accounts to fund the creation of the Shopin ecosystem; and (3) Shopin highlighted the potential for "token appreciation" based on the experience and skills of the management team and the "critical, concrete steps" that Shopin would take to create the ecosystem, including its efforts to obtain adoption of the technology and listing of the token on exchanges.

The SEC also alleges that the defendants misrepresented to investors that (1) Shopin had successfully completed two pilots of the Shopin application at major retailers, (2) Shopin had ongoing partnerships with numerous prominent retailers that were providing Shopin with steady monthly payments, (3) Shopin was being advised by a prominent Silicon Valley blockchain entrepreneur, and (4) a successful online company was a Shopin investor.

In addition, the SEC alleges that Mr. Eyal misappropriated proceeds of the ICO to pay for over US $500,000 of his own personal expenses, as well as to satisfy a judgment against Shopin's predecessor entity.

CRIMINAL CASES

United States v. Randall Crater, No. 19-cr-10063 (D. Mass. filed Feb. 26, 2019)

On February 27, 2019, the U.S. Department of Justice announced the indictment of Randall Crater, founder and principal operator of My Big Coin Pay Inc. ("My Big Coin"), by a federal grand jury sitting for the U.S. District Court for the District of Massachusetts for his alleged participation in a scheme to defraud investors by marketing and selling fraudulent virtual currency. Mr. Crater was charged with four counts of wire fraud and three counts of unlawful money transactions.

Between 2014 and 2017, Mr. Crater (along with two unnamed co-conspirators) allegedly created and marketed virtual currency referred to as "My Big Coins" or "Coins" to investors. Mr. Crater (and others) allegedly falsely represented that My Big Coins were a "functioning virtual currency that had value, were backed by gold and other assets, and could be traded on virtual currency exchange[s]." My Big Coins allegedly were not backed by gold or any other assets; were not readily transferable; and had little to no actual value.

Mr. Crater (and others) allegedly solicited investors directly and created websites and social media accounts to "broadcast misrepresentations about My Big Coins." Investors allegedly were instructed to wire or send money to accounts owned by Mr. Crater, including accounts held by his family members, to purchase My Big Coins. After making purchases, investors would receive false information about their My Big Coins, including false balances of My Big Coins in their accounts and false representations on the My Big Coin website about the increasing value of My Big Coins. Mr. Crater allegedly misappropriated over US $6 million in investor funds for personal use (*e.g.*, for the purchase of artwork, jewelry, antiques, and similar luxury items).

U.S. v. Scott et al., No. 1:17-cr-00630 (S.D.N.Y. filed Oct. 12, 2017)

On November 21, 2019, Mark S. Scott, a former partner at law firm Locke Lord LLP, was convicted of one count of conspiracy to commit money laundering and one count of conspiracy to commit bank fraud in connection with his work for OneCoin Ltd. Mr. Scott was found guilty following a three-week trial in the U.S. District Court for the Southern District of New York.

OneCoin, which was founded in 2014, operates as a multi-level marketing network through which members receive commissions for recruiting others to purchase cryptocurrency packages. OneCoin allegedly claimed that its cryptocurrency was "mined" using company servers and that the value of that cryptocurrency was based on market supply and demand (with the value growing from €0.50 to approximately €29.95 per coin in or about January 2019). In fact, OneCoin's cryptocurrency was not mined usiang computer resources and the value of that cryptocurrency was not based on market supply and demand but rather determined internally. Further, OneCoin's cryptocurrency did not actually operate on a blockchain and, therefore, could not be used to purchase anything.

OneCoin, which continues to operate to this day, claimed to have over three million members worldwide. Records obtained in the course of the government investigation showed that, between Q4 2014 and Q3 2016 alone, OneCoin generated €3.4 billion in sales revenue and €2.2 billion in "profits." Mr. Scott was convicted of laundering approximately US $400 million worth of proceeds from token sales through fraudulent investment funds that he set up and operated. Mr. Scott was paid more than $50 million, which he used to buy a yacht, several seaside homes, and luxury cars.

STATE REGULATORY ACTIONS

***In the Matter of the Inquiry by Letitia James, Attorney General of the State of New York v. iFinex Inc.*, Case No. 450545/2019 (N.Y. Sup. Ct. filed Apr. 24, 2019)**

On April 24, 2019, the New York Attorney General filed a petition in New York state court, alleging that Bitfinex (i.e., iFinex, Inc., BFXNA Inc., and BFXWW Inc.) and Tether (i.e., Tether Holdings Limited, Tether Operations Limited, Tether Limited, and Tether International Limited) hid a loss of more than US $850 million from investors and then used up to US $700 million of U.S. dollar reserves to cover that loss. The petition brought claims for violations of the Martin Act – a New York state law that prohibits (among other things) fraudulent practices "relating to the purchase, exchange, investment advice or sale of securities or commodities" and provides the New York Attorney General "with broad statutory authority to investigate potential violations."

Bitfinex is one of the world's largest cryptocurrency exchanges. Tether is a company that issues a "stablecoin" cryptocurrency called "tethers," which is backed by real world currencies such as U.S. dollars and euros. Since tethers are backed one-to-one by fiat currency, they are thought to be more "stable" and less vulnerable to large swings in value often experienced by other cryptocurrencies.

On May 21, 2019, Bitfinex and Tether moved to dismiss the New York Attorney General's petition on the grounds that the court lacked personal and subject matter jurisdiction. The court denied the motion on August 19, 2019:

The New York Attorney General filed a petition in New York state court, alleging that Bitfinex (i.e., iFinex, Inc., BFXNA Inc., and BFXWW Inc.) and Tether (i.e., Tether Holdings Limited, Tether Operations Limited, Tether Limited, and Tether International Limited) hid a loss of more than US $850 million from investors and then used up to US $700 million of U.S. dollar reserves to cover that loss. The petition brought claims for violations of the Martin Act – a New York state law that prohibits (among other things) fraudulent practices "relating to the purchase, exchange, investment advice or sale of securities or commodities" and provides the New York Attorney General "with broad statutory authority to investigate potential violations."

- Personal Jurisdiction: The court held that it had personal jurisdiction because Bitfinex and Tether had "transacted some business in New York" by allowing New York customers to transact on Bitfinex, permitting New York-based traders to use Bitfinex, agreeing to loan tethers to a New York-based virtual currency trading firm, opening accounts with and using New York-based banks, and having a physical presence in New York through an executive who resided in and worked from the state.
- Subject Matter Jurisdiction: The court held that, although there might be some instances in which a Martin Act case might fall outside of the statute's reach and the court might grant a dismissal, the Martin Act should apply if the issue was a "close call." The court held that it had subject matter jurisdiction because Bitfinex and Tether had not shown that the New York Attorney General's investigation was "utterly irrelevant to any proper inquiry" and Bitfinex's and Tether's arguments about whether tethers are securities were premature.

Bitfinex and Tether appealed the court's decision, and that appeal is currently pending.

In addition, on April 24, 2019, the court issued a preliminary injunction restraining Bitfinex and Tether from accessing Tether's U.S. dollar reserves. The court narrowed that preliminary injunction on May 16, 2019, to restrain Bitfinex and Tether only from accessing Tether's U.S. dollar reserves outside of the ordinary course of Tether's business if it would result in Bitfinex having a claim on those dollar reserves. The court subsequently denied Bitfinex's and Tether's application to stay the preliminary injunction pending the appeal and instead extended the preliminary injunction until 90 days after the appeal has been decided.

Bittrex, Inc. License to Engage in Virtual Currency Business Activity

Bittrex, Inc. ("Bittrex") is a US-based company that owns and operates one of the world's largest cryptocurrency exchanges. Bittrex's digital asset exchange platform allows approximately 1.67 million global users to trade over 200 cryptocurrencies. Bittrex offers two separate platforms, Bittrex and Bittrex International. The former is designed for use by U.S. customers, who are permitted to trade fewer cryptocurrencies than customers on the International platform.

Bittrex applied for a "License to Engage in Virtual Currency Business Activity" (*i.e.*, a "BitLicense") from the New York Department of Financial Services ("DFS") on August 10, 2015, and applied to engage in money transmission activity under the New York Banking Law on July 27, 2018. Bittrex, which has approximately 35,000 New York customers, continued to operate in New York under a "safe harbor" exception granted by DFS, which permits applicants to engage in virtual currency business while their applications are pending.

DFS denied Bittrex's applications and ordered Bittrex to cease operating in New York immediately and to wind down its business in New York within 60 days. In denying Bittrex's application, DFS stated that Bittrex failed to meet DFS's licensing requirements primarily due to (1) deficiencies in BSA/AML/OFAC compliance programs; (2) deficiencies in satisfying DFS' capital requirements; and (3) deficiencies in the due diligence of, and control over, token and product launches.

On April 10, 2019, DFS denied Bittrex's applications and ordered Bittrex to cease operating in New York immediately and to wind down its business in New York within 60 days. In denying Bittrex's application, DFS stated that Bittrex failed to meet DFS's licensing requirements primarily due to (1) deficiencies in BSA/AML/OFAC compliance programs; (2) deficiencies in satisfying DFS' capital requirements; and (3) deficiencies in the due diligence of, and control over, token and product launches. In response, Bittrex stated that it had "worked diligently with NYDFS to address their questions and meet their requirements since first applying for our BitLicense in August of 2015" and "fully disputes the findings of the NYDFS."

PRIVATE LITIGATION

Hodges v. Harrison, 372 F. Supp. 3d 1342 (S.D. Fla. 2019)

On February 8, 2019, the U.S. District Court for the Southern District of Florida granted in part and denied in part the plaintiffs' motion for summary judgment dismissing a putative class action complaint alleging (among other things) that Monkey Capital, LLC and Monkey Capital Inc. (collectively "Monkey Capital") violated Sections 12(a) and 15 of the Securities Act and Section 517.07 of the Florida Securities and Investor Protection Act by selling unregistered securities.

In advance of an ICO scheduled for July 2017, defendants allegedly sought out investors to purchase tokens called "Monkey Coin" and "Coeval" in a pre-ICO offering to raise capital for Monkey Capital, which was supposed to create a private cryptocurrency exchange and decentralized hedge fund. The ICO never took place and the status of Monkey Capital and its projects were unknown at the time of the complaint.

The plaintiffs moved for summary judgment that (among other things) Monkey Coin and Coeval were securities under the federal and state securities laws. Applying the test set forth in *SEC v. W.J. Howey Co.*, the court granted the plaintiffs' motion because (1) the plaintiffs invested cryptocurrencies to purchase Monkey Coin and Coeval; (2) the plaintiffs' funds were pooled by the defendants such that all investors shared in the risks and benefits of Monkey Coin and Coeval; and (3) the success of Monkey Coin and Coeval depended entirely on the defendants' efforts in developing Monkey Capital's projects.

The court granted the plaintiffs' motion because (1) the plaintiffs invested cryptocurrencies to purchase Monkey Coin and Coeval; (2) the plaintiffs' funds were pooled by the defendants such that all investors shared in the risks and benefits of Monkey Coin and Coeval; and (3) the success of Monkey Coin and Coeval depended entirely on the defendants' efforts in developing Monkey Capital's projects.

Balestra v. ATBCOIN LLC, 380 F. Supp. 3d 340 (S.D.N.Y. 2019)

On March 31, 2019, the U. S. District Court for the Southern District of New York denied a motion to dismiss a putative class action complaint alleging that ATBCOIN LLC ("ATBCOIN") and its co-founders and officers (Edward Ng and Herbert W. Hoover) violated Sections 12(a) and 15 of the Securities Act by selling unregistered securities.

From June 12, 2017, through September 15, 2017, ATBCOIN allegedly conducted an ICO of tokens called "ATB Coins" that raised proceeds worth more than US $20 million. ATBCOIN allegedly sought to raise capital so that it could create and launch the ATB blockchain on which the ATB Coins would operate. ATBCOIN allegedly promoted the ATB blockchain as "the fastest blockchain-based cryptographic network in the Milky Way galaxy," and purchasers allegedly expected the value of ATB Coins to increase as more

users adopted the ATB blockchain. When the ATB blockchain launched at the close of the ICO, however, it allegedly did not live up to the technological standards advertised, and the value of ATB Coins allegedly decreased dramatically.

The defendants moved to dismiss the complaint on the ground (among others) that ATB Coins were not securities under the Securities Act. Applying the test provided in *SEC v. W.J. Howey Co.*, the court held that the complaint adequately alleged that ATB Coins were securities and that the sale of ATB Coins was an unregistered securities offering. The parties did not dispute that there had been an investment of money. The court found that there was a common enterprise because the ICO proceeds were "pooled together to facilitate the launch of the ATB Blockchain," the success of which would determine the value of ATB Coins. The court also concluded that there was an expectation of profits to be derived solely from the efforts of others because the success of the ATB Coin was linked to the success of the ATB Blockchain, which was solely in the defendants' control.

Beranger v. Harris, No. 1:18-cv-05054, 2019 WL 5485128 (N.D. Ga. Apr. 24, 2019)

On April 24, 2019, the U.S. District Court for the Northern District of Georgia granted in part and denied in part a motion to dismiss a complaint alleging that the controlling shareholders of FLiK, a company designed to create an online distribution platform for entertainment projects, violated Sections 12(a) and 15 of the Securities Act and Section 10-5-1 of Georgia's Uniform Securities Act by selling unregistered securities.

From August 20, 2017, through September 20, 2017, FLiK allegedly conducted an ICO of FLiK tokens to raise capital to launch the company and its online platform. FLiK never launched. The plaintiffs' FLiK tokens allegedly became essentially worthless, resulting in losses of approximately US $2 million.

The defendants moved to dismiss the complaint on the ground (among others) that FLiK tokens were not securities under the federal and state securities laws. Applying the test set forth in *SEC v. W.J. Howey Co.*, the court held that the complaint adequately alleged that FLiK tokens were securities because (1) the plaintiffs invested cash, Bitcoin, and Ether to purchase FLiK tokens; (2) the value of FLiK tokens depended on the launch of an online platform that did not exist at the time of the ICO; (3) the plaintiffs had a reasonable expectation of profits because the defendants advertised the potential growth in value of the FLiK tokens; and (4) the value of FLiK tokens was based entirely on the defendants' efforts.

The court held that the complaint adequately alleged that FLiK tokens were securities because (1) the plaintiffs invested cash, Bitcoin, and Ether to purchase FLiK tokens; (2) the value of FLiK tokens depended on the launch of an online platform that did not exist at the time of the ICO; (3) the plaintiffs had a reasonable expectation of profits because the defendants advertised the potential growth in value of the FLiK tokens; and (4) the value of FLiK tokens was based entirely on the defendants' efforts.

Audet v. Fraser, No. 3:16-cv-0940 (MPS), 2019 WL 2562628 (D. Conn. June 21, 2019)

On June 21, 2019, the U.S. District Court for the District of Connecticut certified a class of plaintiffs alleging violations of the Exchange Act and the Connecticut Uniform Securities Act in connection with their investments in products of GAW Miners, LLC, and ZenMiner, LLC. GAW Miners and ZenMiner "purchase[d] virtual currency mining equipment from overseas manufacturers" to "resell" to customers. They also sold a variety of virtual currencies and other products – such as Hashlets, Hashpoints, HashStakers and Paycoin – that gave customers an interest in their mining activity and currencies. Stuart A. Fraser, the only remaining defendant in the case, served as the board of directors of both companies.

The complaint alleged that GAW Miners and ZenMiner misrepresented their products, including by (1) overselling their computing capacity; (2) running a Ponzi scheme by paying old investors with funds from ongoing sales; (3) promising that the value of Paycoin would not fall below US $20 per coin; and

(4) representing that there was "significant financial support from outside investors, and that well-known merchants like Amazon and Wal-Mart" would accept their virtual currency.

The court concluded that the class should include individuals who acquired products through mining or by converting one product to another but not individuals who stole products or received them for free. In so doing, the court reasoned that the "purchase and sale" requirement under the federal and Connecticut securities laws should be construed broadly such that individuals who did not purchase or sell the securities in the conventional sense still had standing to be part of the class. Individuals who stole products or received them for free, however, did not suffer any injury from the alleged misconduct and, therefore, lacked standing to be part of the class.

Tezos ICO Cases, No. CJC-18-004978 (Cal. Super. Ct.)

On August 28, 2019, the Superior Court of California for the County of San Francisco granted the motion of Tezos Stiftung ("Tezos") to quash service of summons for lack of personal jurisdiction over the plaintiff's claims. The putative class action complaint alleged that Tezos violated Sections 12(a) and 15 of the Securities Act by selling unregistered securities.

In July 2017, Tezos allegedly conducted an ICO of tokens called "XTZ" or "Tezzies" that raised proceeds worth more than US $230 million. Tezos allegedly sought to raise capital for its blockchain network on which XTZ would operate. The complaint alleged that the court had personal jurisdiction over Tezos because Tezos sold XTZ to California residents through its website, Tezos' founders resided in California, and a federal judge had recently ruled that there was personal jurisdiction over Tezos in a related federal action.

Tezos moved to quash the plaintiff's summons for lack of personal jurisdiction. The court granted Tezos' motion, holding that (1) even though California residents participated in the ICO, Tezos' website was not purposefully directed towards Californians; (2) the residency and conduct of Tezos' founders did not justify the exercise of personal jurisdiction over Tezos; and (3) the legal standard for exercising personal jurisdiction differed between federal and state courts such that the court did not need to follow the ruling of a federal judge in a related federal case.

Leibowitz v. iFinex Inc., No. 1:19-cv-09236 (S.D.N.Y. filed Oct. 6, 2019)

On October 6, 2019, alleged cryptocurrency investors filed a putative class action complaint in the U. S. District Court for the Southern District of New York, alleging that Bitfinex, Tether, and other defendants coordinated to manipulate the price of Bitcoin and disrupted the cryptocurrency market. The complaint brought claims for violations of the Commodities Exchange Act, the Sherman Act, the RICO statute, and the New York Deceptive Trade Practices Law.

The defendants allegedly engaged in a scheme that was "part-fraud, part-pump-and-dump, and part-money laundering" and "primarily accomplished" by Bitfinex and Tether "commingl[ing] their corporate identities and customer funds while concealing their extensive cooperation in a way that enabled them to manipulate the cryptocurrency market with unprecedented effectiveness."

Despite claiming that "the number of [tether] tokens in circulation will always equate to the dollars in its bank account," Tether allegedly "issued extraordinary amounts of unbacked [tether tokens] to manipulate cryptocurrency prices." Specifically, between 2017 and 2018, Tether allegedly created 2.8 billion tether tokens, which it used to "flood the Bitfinex exchange and purchase other cryptocurrencies." Since investors allegedly believed that each tether token was backed by one U.S. dollar, Tether's issuance of tether tokens allegedly made investors believe that there was growing demand for cryptocurrencies and allegedly caused the prices for cryptocurrencies to rise dramatically. Once the price of Bitcoin allegedly was artificially inflated, Tether and Bitfinex allegedly sold the Bitcoin that they purchased with "fake" tether tokens for "real" U.S. dollars, which in turn caused the value of Bitcoin to fall. The defendants' alleged scheme supposedly caused approximately US $466 billion in damages.

Rensel v. Centra Tech, Inc., No. 17-cv-24500, 2019 WL 6828270 (S.D. Fla. Dec. 13, 2019)

On December 13, 2019, the U.S. District Court for the Southern District of Florida granted the plaintiffs' motion for default judgment in a putative securities class action against Centra Tech, Inc. ("Centra Tech"). The putative class action complaint alleged that the defendants violated Sections 12(a) and 15 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in connection with the sale of unregistered securities.

From July 23, 2017, through April 20, 2018, Centra Tech allegedly conducted an ICO of tokens called "Centra Tech Tokens" or "CTR Tokens" that raised proceeds worth more than US $32 million. Centra Tech allegedly was founded in May 2016 to run an ICO to fund (among other things) a debit card backed by Visa and Mastercard that would allow cardholders to make purchases using cryptocurrency.

During the course of the proceedings, all individual defendants were dismissed such that Centra Tech was the only remaining defendant. On January 30, 2019, a clerk's default was entered against Centra Tech for failure to retain counsel and respond to the plaintiffs' amended complaint. Centra Tech moved to set aside the clerk's default on June 15, 2019, but the court denied the motion on September 12, 2019. The court also denied the plaintiffs' motion for class certification on September 16, 2019, and their renewed motion for class certification on November 20, 2019, because the motions were untimely and the class was unascertainable.

The court held that CTR Tokens were unregistered securities sold in violation of the federal securities laws because: (1) the plaintiffs invested digital currencies to purchase CTR Tokens; (2) the success of the CTR Tokens was tied to the success of the products that Centra Tech was developing; and (3) the value of the CTR Tokens was dependent on the efforts and actions of Centra Tech and its founders.

The court ultimately granted the plaintiffs' motion for default judgment. The court held that CTR Tokens were unregistered securities sold in violation of the federal securities laws because: (1) the plaintiffs invested digital currencies to purchase CTR Tokens; (2) the success of the CTR Tokens was tied to the success of the products that Centra Tech was developing; and (3) the value of the CTR Tokens was dependent on the efforts and actions of Centra Tech and its founders. The court also held that Centra Tech made material misrepresentations (1) that its debit card would be backed by Visa and Mastercard and allow purchases using cryptocurrency when, in fact, the card was not authorized to operate on the Visa or Mastercard network and did not allow purchases using cryptocurrency; (2) concerning fictional executives; (3) concerning a nonexistent insurance policy; and (4) concerning state licenses. The court awarded the plaintiffs approximately US $2.9 million in damages. Centra Tech subsequently filed a motion for reconsideration.

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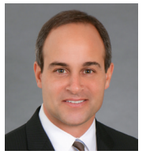

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