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QUINN EMANUEL DIGITAL ASSETS AND BLOCKCHAIN NEWSLETTER

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Are Secondary Token Transactions On Exchanges Securities?

In the spring and into the summer of this year, the U.S. SEC brought enforcement actions against three major crypto exchanges: Bittrex, Binance, and Coinbase (the "Exchanges").[1] In each case, the SEC alleged that the Exchanges have operated as unregistered securities exchanges, brokers, and clearing agencies because various tokens transacted on the exchanges are "securities" subject to SEC regulation.[2] The SEC has alleged that at least the dozens of tokens highlighted in the complaints qualify as "investment contracts" or "investment schemes" and are therefore "securities" under controlling precedent.[3]

The issues raised in these cases have implications for the overall operation of the crypto markets in the U.S. If the SEC were to prevail on any of these cases in full, crypto exchanges offering services in the U.S. could be forced to alter operations dramatically, or perhaps wind down some operations all together. On the other hand, wins by the exchanges could offer the crypto

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1 *SEC v. Bittrex, Inc., et al.* No. 23-cv-580 (D. Wash April 17, 2023) ("Bittrex Complaint"); *SEC v. Binance Holdings Limited, et al.* No. 1:23-cv-01599 (D.D.C. June 5, 2023) ("Binance Complaint"); and *SEC v. Coinbase, Inc., et al*, No. 23-cv-4738 (S.D.N.Y. June 6, 2023) ("Coinbase Complaint").

2 Coinbase Complaint ¶¶ 1-2, 6-7, 74-101; Bittrex Complaint ¶¶ 1-8, 58-62, 110-129; Binance Complaint ¶¶ 1-13, 282-324, 510-513.

3 Coinbase Complaint ¶ 6-7, 114-126; Bittex Complaint ¶¶ 19-43; Binance Complaint ¶¶ 1-4, 315-317.

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Criminal Litigation

- **SBF Found Guilty of Seven Counts of Fraud.** On November 2, the former CEO of fallen crypto exchange FTX was found guilty on all seven counts of fraud and conspiracy leveled against him. Over the course of the month-long trial, the prosecution accused Bankman-Fried of building an elaborate "pyramid of deceit" on a "foundation of lies and false promises," highlighting the testimony of witnesses including Caroline Ellison, Bankman-Fried's ex-girlfriend and former CEO of Alameda Research, Gary Wang, co-founder and CTO of FTX, and Nishad Singh, the exchange's director of engineering, that Bankman-Fried orchestrated the diversion of billions of customer funds. In contrast,

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sector substantial protection and far more certainty than has been available to date in an era characterized by regulation through SEC enforcement.

Over the summer and into the fall, the three exchanges sought to dismiss the SEC's enforcement actions. First, Bittrex moved to dismiss on June 30, 2023. Next, Coinbase moved for judgment on the pleadings on August 4, 2023. Finally, Binance moved to dismiss on September 21, 2023. Bittrex has since settled with the SEC, but Binance and Coinbase have continued to litigate. On October 4, 2023, the SEC first responded to Coinbase's motion and, on October 24, 2023, Coinbase filed a reply in further support of its motion. This note lays out the arguments each side is offering and explains the underlying caselaw driving their disputed interpretations.

The Exchanges focus primarily on two arguments: (1) the SEC has not plausibly alleged that tokens transactions on the Exchanges—almost all of which are secondary market transactions made absent any type of "contract" with an issuer—are "securities transactions" under any accepted legal definition of the term; and (2) under the "major questions" doctrine, the SEC has no authority to regulate such transactions as securities transactions, as such a consequential regulatory decision is reserved for Congress.[4]

Can a Secondary Market Token Transaction That Does Not Involve a Contract Still Be An "Investment Contract"?

Numerous recent district court decisions regarding the application of the securities laws to token transactions have observed that there is never going to be a one-size-fits-all answer to the question of whether transactions in crypto tokens are securities transactions.[5] How the tokens are purchased, from what party, and the reasonable understanding of the parties at the time of purchase—among other distinct factual issues—are all relevant to whether a particular token sale was a security transaction.

In the past, the SEC has brought numerous enforcement actions alleging that sales by token issuers directly to token purchasers are securities transactions.[6] These cases are different. With respect to the Exchanges, the transactions principally at issue are secondary market customer-to-customer transactions where the Exchanges offer customers the ability to buy and sell tokens anonymously through a bid/ask system similar in structure to familiar financial exchanges. Here, the SEC alleges that essentially all secondary market token transactions on the Exchanges satisfy the legal definition of "investment contracts" and therefore are securities transactions under the Securities Act and the Exchange Act.[7]

The Exchanges deny that such transactions could plausibly be "investment contracts" and therefore securities transactions. While token issuers and institutional sellers can buy and sell on the Exchanges, in most instances counterparties are unaware of each other's identity. Therefore, it is difficult or impossible to allege that token purchasers involved in such blind transactions know or believe that they are investing money with a party whom the purchasers expect to use that money in an enterprise that will then generate profits for the purchasers. Without such allegations, the Exchanges contend, the SEC fails out of the gate.

a. Investment Contracts Under Howey

S.E.C. v. W.J. Howey Co., 328 U.S. 293 (1946) is the seminal case setting forth the standards under which federal courts still consider whether a particular transaction is an "investment contract" subject to the Securities Laws.[8] In *Howey,* the Defendant offered its hotel guests an investment opportunity to buy small plots in a citrus orchard. The customers who agreed to invest also entered into services contracts under which another of the Defendant's subsidiaries would maintain the orange trees, sell the oranges, and return profits to the investors. *Id.* at 328, 295-296. The issue in dispute was whether this contractual arrangement—

4 Coinbase and Binance also argue users who "stake" their crypto holdings on the exchange for rewards have not entered into an "investment contract" qualifying that staking transaction as a security. And Coinbase further argues that providing a wallet app whereby users can view and access their crypto holdings does not make Coinbase an unregistered securities broker. An analysis of these issues is beyond the scope of this memorandum.

5 For example, in *Ripple, certain* token transactions made to institutional investors were ruled to be securities, while others to retail investors were ruled not to be. *See Ripple,* 2023 WL 4507900 at *11. *See also SEC v. Kik Interactive Inc.,* 492 F. Supp. 3d 169 (S.D.N.Y. 2020); *SEC v. Terraform Labs Pte. Ltd.*, 2023 WL 4858299 (S.D.N.Y. July 31, 2023); *SEC v. Telegram Group Inc.,* 2020 WL 61528, at *2 (S.D.N.Y. Jan. 3, 2020), discussed infra.

6 *See id.;* Crypto Asset and Cyber Enforcement Actions," U.S. Securities and Exchange Commission (available at https://www.sec.gov/spotlight/cybersecurity-enforcement-actions).

7 Coinbase Complaint ¶ 17; Binance Complaint ¶¶ 3-4;.Bittrex Complaint ¶¶ 50-51, 112-115.

8 *See* Bittrex MTD at 8-9.

the sale of land and the services contract—amounted to an "investment contract" under the securities laws. It was undisputed that the sale of land, without more, would not have qualified as an investment contract. Likewise, the services contract alone would not have qualified.

The Supreme Court held, however, that the two contracts should be considered together in order to understand the "economic reality" of the situation. *Id.* at 298. The Court noted that investment contracts include agreements whereby "a person invests his money in a common enterprise and is led to expect profits solely from the efforts of [a] promoter or a third party." *Id.* at 298–99. Considering the sale contract and the services contract together, it was clear that the investors had entered into an "investment contract" relationship with the *Howey* company under which the investors provided capital for the investment and expected to profit from the efforts of the Howey company.

Thus, under *Howey* and the many cases that have followed it, an investment contract generally requires an agreement between an investor who will provide the investment capital and an entity who will take that capital and use it to fund efforts expected to create profits for the investor.[9] Many investments are not investment contracts—an ongoing contractual relationship out of which the investor expects to profit due to the efforts of others is necessary. For example, a purchase of a collectible such as a baseball card or a piece of art work which an investor hopes will appreciate in value due to market forces is not an "investment contract" because there is no on-going relationship between the buyer and the seller through which the buyer expects to profit thanks to the seller's efforts. The same is true for the purchase of any commodity such as gold, oil, or produce without an ongoing services contract that could reasonably result in profits related to the investment.

Likewise, many contracts involving future obligations are not "investment contracts" because no "investment" was made. For example, a contract between a homeowner and a company whereby the company agrees to mow the homeowner's lawn regularly in order to maintain or increase the home's value is not an "investment contract" because no "investment" is at issue, even if the homeowner expects to profit off the arrangement by selling the house at a higher price. Seeking to crystallize these understandings, *Howey* held that an "investment" requires (1) an investment of money; (2) into a common enterprise; (3) with a reasonable expectation of profits; and (4) that those profits derive from the efforts of others. 328 U.S. at 298–99, 301.

It is when these two concepts come together, an "investment" into a common enterprise and a "contract" with the sponsor or promoter of that investment for future services reasonably expected to result in profits for the investor, that an "investment contract" is formed.

Thus, as in *Howey,* a contract to purchase a parcel of land, without more, is not an "investment contract" because there is no ongoing relationship between the buyer and seller whereby the efforts of the seller would result in additional profits for the buyer. A contract to purchase a parcel of real estate, along with a services contract which states that the seller will also work to maintain the property, run a business on the property, and pay any profits from that business to the buyer would qualify as an "investment contract."[10]

b. The Exchanges Argue Secondary Market Purchases of Tokens Cannot Be Investment Contracts

The Exchanges argue that purchases of tokens on the secondary market through their platforms do not even resemble an "investment contract,"[11] and that the SEC has failed to plausibly allege that any such transactions qualify as securities transactions. The only "contract" at issue in this circumstance is the agreement between two parties transacting in a blind bid/offer setting for the purchase of the token. This contract for the simple sale of a token includes no ongoing relationship between the buying and selling parties, let alone between the buyer and the issuer or promoter (such as the services contract at issue in *Howey*), and therefore, they argue, cannot qualify as an "investment contract."[12]

The Exchanges appear to acknowledge that it would be possible that an agreement between a purchaser and the issuer or promoter of a token could qualify

9 *See* Bittrex MTD at 8-11; Coinbase MJP at 6-13; Binance MTD at 14-19.

10 *See* Bittrex MTD at 10 (collecting cases).

11 *See* Bittrex MTD at 8-11; Coinbase MJP at 6-13; Binance MTD at 14-19.

12 Binance MTD at 14-15 (collecting cases).

as an "investment contract."[13] In the context of such a purchase, the purchaser could reasonably expect the token to appreciate in value as a result of the issuer's efforts to promote the token, provide technical support to the token, and grow the token's network. When a retail investor purchases a token on the secondary market, however, that investor has not entered into any agreement with the issuer of the token whereby the purchaser expects to extract profit because of the issuer's efforts related to the token. There simply is no "contract" between the purchaser of the token and the issuer or promoter of the token. The Exchanges argue that this lack of contractual privity is fatal to the SEC's allegation that these transactions amount to investment contracts.[14]

c. The SEC Argues That Tokens Are "Investment Schemes"

The SEC has indicated that its position is that the sales of tokens constitute "investment schemes" which, under *Howey,* may qualify as "investment contracts" even in the absence of a formal contract between investor and promoter.[15] In making this argument, the SEC relies heavily on the fact that *Howey* held that "an investment contract for purposes of the Securities Act means a contract, transaction, *or scheme* whereby a person invests his money in a common enterprise." 328 U.S. at 298–99 (emphases added). The Court noted that this broad understanding of "investment contract" is necessary "to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." Howey Co., 328 U.S. at 299. *Howey* was decided against a backdrop of businesses seeking to creatively structure investments in order to evade the federal securities laws and state Blue Sky laws, and the *Howey* court emphasized that the federal Securities laws had to be flexible enough to deal with new and unforeseen business schemes.[16]

For example, in one older case, a business offered to sell investors small parcels of land on an installment basis. Once a certain amount of installment payments were made, the company would plant and cultivate fig trees on the parcel. The company agreed to cultivate and maintain the trees on the parcels for five years. Once all installment payments were made, the company would transfer ownership of the land to the investor, with a potential promise to also purchase figs from the investor. *State v. Agey,* 88 S.E. 726, 729 (N.C. 1916).[17] The Court there held that such a company was an "investment company" subject to registration under South Carolinian securities law, regardless of the obscure way that the investment was marketed and papered.[18]

Generally, the SEC argues, when an asset purchase is a mere proxy for the investment of money in exchange for future cash flows from a business endeavor, that asset purchase may be an "investment scheme." Likewise an investment scheme may exist where multiple contracts between two parties, if viewed together, show that one party expects to invest capital in order to obtain future business cash flows.[19] In this context courts look to the "economic reality" of the relationship between the parties in order to evaluate whether an investment contract exists. *See Howey,* 328 U.S. at 298-99.

The Exchanges counter that the SEC's allegation that the tokens are "investment schemes" does not obviate the requirement that there be a "contract" between investor and promoter.[20] On the contrary, the investment scheme cases generally deal with *multiple* contracts between the parties which are structed in a way to evade the securities laws, not a lack of any contract at all. Indeed, this was just the case in *Howey,* where no single contract between the parties was an "investment contract," but the sale contract considered alongside the services contract made it clear that an investment contractual arrangement had been agreed between the parties.

In the case of secondary market purchases of tokens, there simply is no contract at all between the issuer or promoter of the token and the investor. As discussed above, the only contractual relationship that exists is between the buyer and seller of the token through the anonymous bid/ask system in place on the Exchanges.

13 Bittrex MTD at 12-13; Coinbase MJP at 13-17.

14 Bittrex MTD at 20; Coinbase MJP at 18-19; Binance MTD at 20-24.

15 Coinbase Complaint ¶ 6-7, 114-126; Bittex Complaint ¶ 19-43; Binance Complaint ¶¶ 1-4, 315-317.

16 The Exchanges acknowledge this flexibility in the definition. Bittrex MTD at 8-9; Binance MTD at 14-16.

17 *See State v. Robbins, 2*40 N.W. 456, 456 (Minn. 1932) (contract for sale of breeding muskrats and contract for breeding and management services "together . . . constitute a sale of an interest in a profit-sharing scheme").

18 *See also* Coinbase MTD at 7-8 (collecting cases).

19 *See* Coinbase MJP at 11.

20 *See* Binance MTD at 17-18.

d. The SEC Argues Recent Case Law in the Crypto Context Alters Prior Understandings

An alternative argument the SEC offers is that, while it may be true that the "investment contract" case law developed in the middle of the twentieth century requires an ongoing contractual relationship between the investor and the promotor of the investment, recent cases decided in the crypto sector point in a new direction.

The SEC relies particularly upon two recent cases for the proposition that an "investment scheme," particularly in the case of crypto, might not require an ongoing contractual relationship: *SEC v. Kik Interactive Inc.,* 492 F. Supp. 3d 169 (S.D.N.Y. 2020), and *SEC v. Terraform Labs Pte. Ltd.,* 2023 WL 4858299 (S.D.N.Y. July 31, 2023). These cases involved actions against token issuers, not secondary market exchanges. In *Kik,* Judge Hellerstein accepted the SEC's contention that "an ongoing contractual obligation is not a necessary requirement for a finding of a common enterprise." 493 F. Supp. 3d at 178. *Terraform*, for its part, rejected an argument that an "investment contract" requires "a formal common-law contract between transacting parties," and concluded that no "enforceable written contract" is required to establish the existence of an investment contract. 2023 WL 4858299, at *11.

The Exchanges argue that those district court decisions are contrary to decades of established precedent and should not be followed.[21] Regardless, the Exchanges argue that the SEC has not, and cannot, argue that the secondary market transactions on the Exchanges are investment schemes similar to those the Courts identified in *Kik* and *Terraform.* In those cases, at least some investors provided investment capital to the issuers of the tokens themselves when they purchased their tokens, and the court could reasonably conclude that those investors expected their tokens to increase in value as a result of the efforts of the issuer. But transactions on the secondary market—where often retail investors purchase from other retail investors—generally do not result in any investor capital being invested with the issuer or promoter itself. Thus, the Exchanges argue, there has been no "investment" into a "common enterprise" as needed to qualify as an "investment contract."[22] The Exchanges argue that this missing element—the involvement of the issuer or promoter in the transaction—is fatal to the SEC's reliance on *Kik* and *Terraform* even if the court agrees that those cases eliminate the requirement that there be a "contract."

The Exchanges further contend that the *Ripple* summary judgment decision is in accord with this understanding. *See Ripple,* 2023 WL 4507900, at *11 (no investment contract where buyers "could not have known if their payments of money went to [an issuer], or any other seller of" the subject token). The Exchanges argue that *Ripple* stands for the proposition that blind bid-ask transactions on an exchange, without any agreement to any future commitment between buyer and seller, cannot be investment contracts.[23] *Id.* at *11-12. This lack of post-sale obligations between the buyer and seller on the secondary market, the Exchanges argue, shows that the SEC has not plausibly alleged its claim.[24]

e. The Latest Salvo: Coinbase's Reply

On October 24, 2023, Coinbase filed a reply in further support of its motion for judgment on the pleadings. This is the first direct response to the SEC's arguments that any of the exchanges has filed, as Bittrex settled its case prior to filing a reply and Binance's briefing schedule is behind Coinbase's.

On reply, Coinbase argues forcefully that the SEC's position requires the court to take a novel legal position, and depart from precedent that has conclusively established the meaning of "investment contract." Coinbase contends that the SEC's arguments that there need not be a "contractual undertaking" or even an "investment" to establish the existence of an "investment contract" is directly contradicted by relevant Supreme Court case law. *See SEC v. Edwards,* 540 U.S. 389, 397 (2004) ("We are considering investment *contracts*.") (emphasis in original).[25]

Coinbase argues that the SEC's position would render the term "securities" unreasonably broad and grant the

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21 Coinbase MJP at 13.

22 Bittrex MTD at 8-9; Binance MTD at 19 ("Whether analyzed under the 'investment of money' or 'common enterprise' prongs, case law dictates what logic and Howey make clear; there can be no 'investment contract' unless the buyer's 'investment of money' flowed into the relevant 'common enterprise.'").

23 Binance MTD at 18.

24 Binance MTD at 18.

25 Coinbase Reply at 1-2.

SEC the right to regulate virtually any commercial activity whatsoever.[26] Coinbase notes (as discussed further below) that the SEC does not have the authority to redefine the scope of its regulatory authority in this way.

Coinbase also argues that the SEC's reading of *Howey's* use of the phase "investment scheme" is simply incorrect, and that this phrase never eliminated the need for a "contractual undertaking" in order for a given scheme to qualify as a "security."[27] Given that, in *Howey*, there were multiple contracts at issue that had to be read together to understand the "investment scheme," this language from the same case cannot provide a basis to argue that an "investment scheme" might exist in the *absence of any contract.*

Coinbase also responds to the SEC's reliance on *Terraform* and *Kik*, arguing that, in each of those cases, contractual privity existed between the purchasers and the issuers of the tokens. Coinbase emphasises that there is no reading of these cases which would extend the meaning of "investment contract" to secondary market purchases of tokens in a blind bid/ask setting.[28]

Major Questions Doctrine: Will Federal Courts Require Congress, And Not The SEC, To Regulate The Crypto Market

Each of the Exchanges separately argue that the courts should apply the "Major Questions Doctrine" to disallow the SEC from regulating the crypto market through enforcement action and regulation.[29] Under that doctrine, when an agency's interpretation of a statute implicates major political and economic issues, the agency must have "clear congressional authorization for the power it claims." *West Virginia v. EPA,* 142 S. Ct. 2587, 2609 (2022).

The Supreme Court has previously applied this doctrine to limit administrative action in other instances where large economic impact was at issue. *See, e.g., Biden v. Nebraska,* 143 S. Ct. 2355, 2372 (2023) ("$430 billion in student loans" at issue); *Ala. Ass'n of Realtors v. HHS,* 141 S. Ct. 2485, 2489 (2021) (per curiam) ($50 billion at stake). The Supreme Court has also applied this doctrine where a given question is of political significance, and where an agency has previously disclaimed its power to regulate the issue in question. *See, e.g., Nebraska,* 143 S. Ct. at 2364 (Department of Education had disclaimed "statutory authority to provide blanket or mass cancellation" of student loans).

The Exchanges argue that the Major Questions Doctrine should be applied in this case. First, there is no dispute that the crypto asset trading markets that would be affected by the SEC's actions involve transactions billions of dollars—likely hundreds of billions or more.[30] Second, the Exchanges argue that the SEC's lawsuits implicate "vast political significance."[31] The Exchanges note that Congress is considering at least twenty legislative proposals regarding the regulation of the crypto market. The SEC's lawsuits would undermine this democratic process by imposing the SEC's preferred regulatory scheme.

The Exchanges further note that the SEC has previously disclaimed its ability to regulate the crypto transactions at issue here. The SEC's chairman has stated that the SEC lacks a "regulatory framework" for crypto exchanges,[32] and the SEC took no action against crypto exchanges while they were being built. The Exchanges argue that these actions indicate that even the SEC did not consider the transactions at issue here to be "securities" until recently.

Thus, the Exchanges argue that there has been no "clear congressional authorization" for the SEC's authority here.[33] The Exchanges argue that the SEC's adoption of a novel interpretation of "investment contract" to mean a situation lacking both an "investment" and a "contract" as previously understood under the case law is a "paradigmatic major question" requiring Congressional action.[34] One way or the other, it is likely that this question will have to be answered by a federal appeals court, if not the Supreme Court.[35]

26 Coinbase Reply at 2-3.

27 Coinbase Reply at 4-5.

28 Coinbase Reply at 7-8.

29 *See* Bittrex MTD at 15, Binance MTD at 31, Coinbase MTD at 21.

30 Bittrex MTD at 15; Binance MTD at 31-32.

31 Bittrex MTD at 15; Binance MTD at 32.

32 Bittrex MTD at 15; Binance MTD at 33.

33 Bittrex MTD at 15; Binance MTD at 33.

34 Binance MTD at 33-34.

35 On Reply, Coinbase notes that the SEC fails to meaningfully rebut the Exchanges' arguments with respect to the Major Questions Doctrine. Coinbase argues that the SEC's reliance on *Kik* and *Terraform* for the proposition that the SEC may regulate crypto markets is insufficient.

Conclusion

The courts will ultimately decide which side has the better arguments on this issue—in all likelihood the appellate courts. Although the Exchanges have strong arguments under Howey and its 20th century progeny, recent decisions in *Telegram, LBRY, Kik, Terraform* and other cases where the SEC has had some success leave open the possibility that a judge may be willing to stretch the definition of "investment contract" or "scheme" to encompass some or all secondary market transactions on the Exchanges.

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defense counsel portrayed Bankman-Fried as a "nerdy high school math guy" who unwittingly became the center of the government's movie-villain narrative. The jury deliberated for less than five hours before coming to a verdict. Bankman-Fried will be sentenced on March 28, 2024 and faces up to 110 years in prison.

- **Oyster Pearl Crypto Founder Gets 4 Years for Tax Fraud.** On October 31, Amir Bruno Elmaani was sentenced to four years in prison—the maximum statutory sentence—for tax offenses in connection with the Oyster Pearl token he founded under the pseudonym "Bruno Block." Elmaani had pled guilty earlier this year to secretly minting and selling Pearl tokens for his own profit, thus causing the price of the tokens to plummet, and failing to pay $5.5 million in income taxes on the gains. According to the DOJ, Elmaani funneled crypto proceeds through friends and family to his own accounts, from which he took out $10 million to purchase real estate, home renovations, and yachts which he used to store his gold bar collections.

- **Airbit Club Co-Founders Get Prison Time.** On September 26, New York District Judge George B. Daniels sentenced Pablo Renato Rodriguez to 12 years in prison for running a multimillion dollar cryptocurrency pyramid scheme. Judge Daniels also sentenced co-founder Gutemberg Dos Santos, who cooperated with federal prosecutors, to 40 months in prison on October 4. Rodriguez, Dos Santos and other promoters had allegedly lured investors to buy "memberships" in Airbit Club with the false promise that they would earn returns on cryptocurrency trading, and then spent those funds on luxury travel, jewelry, and real estate.

- **Former Celsius Exec Pleads Guilty to Fraud Charges.** On September 14, Roni Cohen-Pavon, former chief revenue officer at now-bankrupt exchange Celsius Network, pled guilty to four criminal charges, including securities fraud and manipulating the price of the company's token CEL. In July, Prosecutors charged Cohen-Pavon and Celsius founder Alex Mashinsky with misleading investors and siphoning customer funds from the platform into their own pockets. Cohen-Pavon's sentencing is set for December 2024. According to the plea agreement, he may be eligible for leniency if he agrees to cooperate against Mashinsky, whose trial will start September 2024.

- **OneCoin Co-Founder Sentenced to 20 Years.** On September 12, New York District Judge Edgardo Ramos sentenced Karl Sebastian Greenwood to 20 years in prison and ordered him to forfeit $300 million for his role in a multibillion dollar pyramid scheme. Greenwood founded OneCoin in 2014 with "CryptoQueen" Ruja Ignatova, luring 3.5 million people into investing over $4 billion in a cryptocurrency with no intrinsic worth. The victims, prosecutors noted, are unlikely to recover any of their money. Ignatova remains at large.

- **Collapsed Crypto Exchange Founder Sentenced to 11,196 Years.** On September 8, a panel of judges in Turkey sentenced Faruk Fatih Ozer, the founder of defunct crypto exchange Thodex to 11,196 years in jail. Thodex was one of Turkey's largest crypto exchanges until April 2021, when $2 billion in investor assets suddenly disappeared and Ozer went into hiding. According to the BBC, such long prison sentences are relatively common in Turkey. Prosecutors had sought 40,000 years for Ozer on charges of fraud, money laundering, and operating a criminal organization.

- **Salame Pleads Guilty to Fraudulent Contribution Charges.** Former FTX Digital Markets chief executive Ryan Salame pled guilty on September 7 to funneling tens of millions of dollars from Alameda Research into political donations in his own name in a bid to boost the company. Salame agreed to forfeit $1.5 billion and pay $5.6 million in restitution to FTX debtors. Unlike plea deals for other top FTX executives, the deal did not include an agreement to cooperate with authorities

against ex-CEO Sam Bankman-Fried.

Governmental Action

- **SEC Drops Claims Against Ripple Executives.** On October 19, 2023, in a decision Ripple lauded as a "landmark SEC surrender," the SEC dropped its civil claims against Ripple CEO Brad Garlinghouse and co-founder Chris Larsen, which had been set for trial following a summary judgment decision regarding other claims in the SEC's case against Ripple. The SEC had claimed that the two executives aided and abetted Ripple's sale of unregistered securities. Earlier this year, U.S. District Judge Analisa Torres dealt a blow to the SEC's case by ruling that various alleged XRP transactions were not unregistered sales of securities.

- **SEC Brings Suit Against Prager Metis For Auditor Rule Violations.** On September 29, 2023, the SEC filed suit in the Southern District of Florida seeking a permanent injunction and disgorgement of profits against Prager Metis, one of the auditors which provided services to FTX prior to its bankruptcy. Specifically, the SEC alleges that Prager entered into agreements whereby its clients agreed to indemnify Prager for any liability arising out of the auditor's own negligence. The SEC's auditor rules specify that this kind of indemnification provision is impermissible for an independent auditor. The SEC alleges that Prager entered into at least 51 engagement letters containing such indemnification agreements.

- **LBRY Drops Appeal of Ruling That Its Token Is An Unregistered Security.** On September 7, Blockchain-based digital content network LBRY Inc. filed a notice of appeal challenging a New Hampshire federal judge's ruling that certain transactions in the company's native token, LBC, were unregistered securities transactions. But, on October 20, LBRY dropped the appeal, stating in a blog post: "LBRY Inc. has debts to the SEC, its legal team, and a private debtor that it cannot pay. Its assets, including Odysee, are being placed into receivership. As of this post, all LBRY executives, employees, and board members have resigned. All will be doing what is required to satisfy any outstanding legal requirements, but no more."

- **NY AG Alleges That Gemini and Genesis Defrauded Investors of Over $1B.** New York Attorney General Letitia James filed suit in New York state court on October 19, alleging that crypto exchange Gemini, bankrupt crypto lender Genesis, and its parent company Digital Currency Group lied to investors about the level of risk involved in the Gemini Earn program. The suit also alleges that DCG and Genesis concealed from Gemini Genesis' financial condition and lied about $1 billion in losses as the company headed towards collapse in 2022. It was ordinary New Yorkers and middle-class investors who bore the brunt of the fraud, losing millions of dollars in life savings, said James in a statement. In a post on X, Gemini stated that the lawsuit "confirms what we've been saying all along—that Gemini, Earn users, and other creditors were the victims of a massive fraud," but that it disagreed with the AG's decision to also sue Gemini.

- **CFTC's Largest Bitcoin Fraud Case Settles for $1.7B.** On September 6, a Texas federal judge signed off on a consent order requiring Mirror Trading International to pay over $1.7 billion to settle claims by the CFTC. The CFTC claimed that the company, run by South African CEO Cornelius Johannes Steynberg, engaged in a fraudulent scheme to solicit $1.7 billion in Bitcoin from Americans for participation in an unregistered commodity pool. Mirror had advertised that its proprietary trading "bot" would help members achieve profits of 10% per month. In fact, no such bot existed and the participating Bitcoin was transferred straight to Steynberg's E-Wallet.

- **D.C. Cir. Vacates SEC's Rejection of Grayscale Bitcoin ETP.** On August 29, the D.C. Circuit overturned the SEC's denial of Grayscale Investment's bid to turn its Bitcoin trust into an exchange-traded product (ETP). The three-judge panel found that the Commission had failed to "treat like cases alike" by approving materially similar bitcoin future ETPs but denying Grayscale's petition. Absent appeal, the application now returns to the SEC, which will need to decide whether to approve it or to deny it on different grounds. Grayscale has urged the Commission to press forward with an approval, but SEC Chairman Gary Gensler refused to offer any indication as to whether approval would be forthcoming in a recent appearance before the U.S. Senate.

Bankruptcy Litigation

- **BlockFi Begins Post-Bankruptcy Wind-Down.** On October 24, crypto platform BlockFi began the process of winding down its operations and repaying its creditors. The company filed for bankruptcy last November, following the collapse of FTX. Its Chapter 11 plan was approved on September 23. BlockFi says that it plans to pursue litigation to recover assets it believes FTX, 3AC, and other companies owe it and distribute assets back to clients.

- **Bankruptcy Judge Signs Off on $175M Genesis-FTX Settlement.** On October 6, 2023, New York Bankruptcy Judge Sean Lane approved a settlement between Genesis and FTX that would allow FTX affiliate Alameda Research to receive a $175 million unsecured claim in the Genesis bankruptcy. The agreement will resolve a nearly $3.9 billion claim brought by FTX and its debtors against the Genesis estate. Judge Lane said that the agreement would avoid litigation of the FTX claims, which would be "inherently uncertain" and "raise novel legal issues," given that the defenses available to the Genesis debtors have not previously been addressed in the cryptocurrency context.

- **FTX Sues SBF Parents for Millions in Damages and Clawbacks.** On September 18, FTX, represented by Quinn Emanuel, filed a complaint in Delaware Bankruptcy Court against the parents of former CEO Sam Bankman-Fried seeking to recover millions of dollars in alleged fraudulent transfers. The complaint alleges that Allan Joseph Bankman and Barbara Fried, both tenured professors at Stanford Law School, "exploited their access and influence within the FTX enterprise to enrich themselves" at the expense of FTX and its creditors. Bankman and Fried, according to the suit, positioned themselves as corporate insiders and facilitated improper transactions to the family—including a $10 million cash gift and a $16.4 million luxury property in The Bahamas—while the company was on the brink of insolvency.

- **Bankruptcy Judge OKs FTX's Crypto Sale Program.** On September 13, District of Delaware Bankruptcy Judge John Dorsey approved FTX's proposal to begin to sell crypto holdings worth around $3.4 billion in order to ultimately pay its creditors. Under the program, the collapsed company is authorized to sell up to $100 million in cryptocurrency per week and possibly increase that amount to $200 million per week. Judge Dorsey also approved FTX's request to hire investment adviser Galaxy Digital Holdings to sell estate assets and engage in hedging transactions.

Civil Litigation

- **Investors Appeal to Hold Crypto Exchange Accountable for Scam Tokens.** A group of crypto investors suing Uniswap filed a notice of appeal to the Second Circuit on September 27, seeking to overturn Judge Katherine Polk Failla's dismissal of the DeFi platform and its venture capital backers (including Andreessen Horowitz) from their scam token suit. While sympathizing that the plaintiffs had suffered losses from investing in fraudulent tokens of unknown provenance traded on Uniswap, Judge Failla had held that they could not sue the platform and venture capital defendants in lieu of the actual wrongdoers. Judge Failla drew a parallel between Uniswap and regular stock exchanges, noting that imposing liability on "those whose role is solely to execute the trades" would be tantamount to inviting stockholders to sue the NASDAQ or NYSE for any undesirable stock purchase. The proposed class action is one of first impression.

- **Celebs Urge California District Court to Toss Bored Ape NFT Suit.** On September 12, a group of celebrities including Paris Hilton, Jimmy Fallon, Justin Bieber, Madonna, and Kevin Hart filed motions to dismiss a federal suit brought by disgruntled investors in Yuga Labs' Bored Ape NFTs when the prices of the tokens plummeted. The investors claimed that, by endorsing the primate-imprinted digital tokens, these celebrities were united in a scheme with Yuga Labs and NFT investment service MoonPay to trick buyers into buying "losing investments at drastically inflated prices." Hilton contended that the plaintiffs failed to plead that she even profited from her NFT and that her statement on Fallon's late night show and subsequent "Loves It!" tweet were nothing but innocuous statements of enthusiasm. "Celebrities discussing NFTs that they acquired is not securities fraud," said Fallon's motion.

Regulatory and Policy Developments

- **SEC Chair Gensler Says Crypto Industry "Rife with Noncompliance."** Speaking at the 2023 Securities Enforcement Forum on October 25,

U.S. Securities and Exchange Commission Chair Gary Gensler called the cryptocurrency industry "really rife with noncompliance." Gensler averred that crypto transactions generally should be subject to securities regulations, stating that "the vast majority of crypto assets likely meet the investment contract test, making them subject to the securities laws." The Chair's statements echoed his previous descriptions of the crypto industry as a Wild West teeming with "hucksters, fraudsters, scam artists, Ponzi schemes."

- **Crypto Delistings Hit Record Number.** The number of crypto tokens delisted from exchanges hit a record high of over 3,400 this year, according to data compiled by Kaiko. This is double the amount in 2021, and the highest number since 2016. Trading on most exchanges has also fallen in the past year, despite over 1.8 million new coins being listed. Riyad Carey, an analyst at Kaiko, explained that the number of delistings may be the consequence of the "aggressive listing" and resultant explosion of new tokens "during the last bull market," which have since "faded away or folded in the bear market."

- **FinCEN Proposes Reporting Requirements For Crypto Mixers.** On October 19, the Treasury's Financial Crimes Enforcement Network released a notice of proposed rulemaking, unveiling a plan to impose new recordkeeping and reporting requirements on domestic entities engaging in crypto mixer transactions. The proposed rules are aimed at curtailing money laundering by illicit actors like cyber criminals and terrorist groups, and mark a first-time use of a provision of the Patriot Act that grants the Treasury authority to impose "special measures" on domestic financial institutions upon finding that a class of transactions is of primary money laundering concern.

- **CA Crypto Licensing Bill Becomes Law.** On October 13, California Governor Gavin Newsom signed A.B. 39, a bill establishing a comprehensive licensing framework for the cryptocurrency industry. The new Digital Financial Assets Law, effective July 1, 2025, will prohibit crypto traders from engaging in crypto business activity until they are licensed with the state Department of Financial Protection and Innovation. The law also bars trading of stablecoins except those specifically permitted by the Department, based on its finding that an exemption is "in the public interest." The framework follows in the footsteps of New York's BitLicense scheme, and those already licensed in New York are eligible for a conditional license in California. Newsom **said** that the bill will require "further refinement in both the regulatory process and in statute."

- **NY Department of Financial Services Proposes New Crypto Listing Standards.** The New York State Department of Financial Service (DFS) released a new proposed General Framework for Greenlisted Coins and updated list of pre-approved tokens on September 18. The proposed framework imposes stricter requirements for coin listings and delistings, including requiring virtual currency entities that wish to self-certify coins outside of the pre-approved list to create a coin-listing policy for DFS's approval. In addition, all virtual currency entities that list coins are to implement delisting policies under the new guidance. The DFS is seeking public comments on the proposal until October 20 but has encouraged entities to start creating delisting policies. The proposal is part of DFS's initiative to cement its "role as the leading regulator of virtual currency in the nation."

- **Calls to Treat Crypto Traders Like Commodities Traders Under Fed Tax Code.** In a September 8 response to a request by the Senate Finance Committee for input on the taxation of digital assets, the American Bar Association Section of Taxation proposed that legislators treat crypto traders like commodities dealers under Internal Revenue Code Section 475, allowing them to elect to use mark-to-market accounting. The Section explained that because NFT and crypto traders engage in dealer-like activities in established markets, they too should be allowed to avail themselves of the lower accounting burdens and clear reflection of income that mark-to-market accounting enables. Joining the call was the Crypto Council for Innovation, which noted in its own letter that this recommendation tracks the Biden Administration's recent Green Book of tax proposals.

QE on the Block
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