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Et tu, Paul?

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On Feb. 17, Paul Pierce — the NBA Hall of Famer, the former Boston Celtics all-star, and the former ESPN analyst — became the latest celebrity to settle with the Securities and Exchange Commission ("SEC") over crypto violations.

While the settlement attracted significant popular media attention, particularly because this settlement was the first one involving a basketball celebrity, the settlement is more interesting for other legal reasons.

For the SEC, stock touting cases are generally easy to prove.

In particular, unlike other prior celebrity crypto touting cases, the Pierce settlement included an anti-fraud (albeit non-scienter) violation for misrepresentation — and the SEC demanded the highest civil penalties for this type of case to date. The SEC's approach in the Pierce settlement may foreshadow how the SEC will address celebrity crypto touting cases in the future.

Background on stock touting

First, some background on touting. Under Section 17(b) of the Securities Act of 1933, it is unlawful for any person to tout a security without disclosing the nature and substance of any consideration, whether present or future, direct or indirect, received from an issuer, underwriter or dealer.[1]

Or to put in the words of SEC's Chair Gary Gensler in the Pierce settlement press release, "[t]he law requires you to disclose to the public from whom and how much you are getting paid to promote investment in securities."

Historically, Section 17(b) focused on "scalping" — "a practice in which the owner of a security recommends it for investment and then sells it at a profit."[2] "Section 17(b) was designed to protect the public from publications that 'purport to give an unbiased opinion but which opinions are in reality being paid for.'"[3]

For the SEC, stock touting cases are generally easy to prove. As long as the individuals publicizing stock in which they deal did not disclose their "receipt" of compensation and "the amount thereof," the violation is established.[4] Intent or scienter is not required to establish a violation of Section 17(b).[5]

And as the Second Circuit explained, "[a]ny receipt and amount of [ ] compensation are material information, the disclosure of which is required by law."[6]

Stock touting cases are legion, and have been around for many years. And they have frequently arisen in the microcap/over-the-counter markets, where the SEC has brought enforcement actions alleging violations of Section 17(b), as well as others, usually fraud charges, against penny stock promoters who did not disclose their compensation arrangements when they engaged in promotional activities for the stocks in question.

In many such cases, particularly when the criminal authorities are implicated, the promoters have been found to have worked in tandem with others to engage in (or to aid and abet) market manipulation schemes.

SEC's use of the anti-touting provisions under Section 17(b) in crypto cases

The SEC's use of Section 17(b) in the crypto space, however, is more recent. On November 1, 2017, the SEC's Divisions of Enforcement and Examinations issued a statement entitled *SEC Statement Urging Caution Around Celebrity Backed ICOs*.[7]

Pierce also made multiple materially false and misleading statements in his Twitter posts.

In its statement, the SEC said that celebrity endorsements "may be unlawful if they do not disclose the nature, source, and amount of any compensation paid, directly or indirectly, by the company in exchange for the endorsement" and that "[i]nvestors should note that celebrity endorsements may appear unbiased, but instead may be part of a paid promotion."[8]

That SEC statement re-appeared more than a year later, on November 29, 2018, when the SEC issued its press release announcing that it had brought its first two celebrity crypto touting enforcement actions.

In those action, the SEC brought and settled enforcement actions against two celebrities — professional boxer Floyd Mayweather Jr.

and music producer DJ Khaled — for unlawfully touting on social media Initial Coin Offerings ("ICOs"), in violation of Section 17(b).

The SEC's administrative orders provided, on a neither admit nor deny ("NAND") basis, that Mayweather and Khaled failed to disclose promotional payments from ICO issuers ($300,000 for Mayweather from three issuers, including Centra Tech Inc.; $50,000 for Khaled from Centra Tech) when they were promoting them.

According to the SEC's orders, Khaled called Centra Tech ICO a "Game changer" and Mayweather told his Twitter followers that Centra's ICO "starts in a few hours. Get yours before they sell out, I got mine ...." Mayweather made four posts, in total, on his social media (Facebook, Instagram, and Twitter) accounts and Khaled posted once on his Instagram and Twitter accounts.

For their touting violations — which did not include any challenges on whether the crypto assets in question were a "security" under the federal securities laws — both paid full disgorgement, with prejudgment interest, and civil penalties that equaled (for Khaled) or doubled (for Mayweather) their disgorgement amounts.

The SEC said that celebrity endorsements "may be unlawful if they do not disclose the nature, source, and amount of any compensation paid."

Finally, they agreed to an undertaking that prohibited each from promoting any securities, digital or otherwise, for two (Khaled) or three (Mayweather) years.

The next notable celebrity crypto touting enforcement action involved actor Steven Seagal. In February 2020, the SEC announced that it had brought a settled Section 17(b) enforcement action against Seagal for failing to disclose payments he received for promoting an ICO conducted by Bitcoiin2Gen ("B2G").

The SEC's administrative order provided, on a NAND basis, that Seagal failed to disclose that he was promised $250,000 in cash and $750,000 worth of B2G tokens in exchange for his promotions on his social media accounts (Twitter and Facebook). According to the SEC, Seagal encouraged the public not to "miss out" on B2G's ICO and endorsed the ICO "wholeheartedly."

Segal promoted B2G on four posts on social media in the span of 22 days. Like the Mayweather and Khaled settlements, the SEC required Seagal to disgorge all his promotional payments (in this case, $157,000), with prejudgment interest, and civil penalties that equaled the disgorgement amount.

In addition, Seagal agreed to an undertaking that prohibited him from promoting any securities, digital or otherwise, for three years.

The next splashy celebrity crypto touting case came in October 2022 — after the change in administration.[9] Media personality Kim Kardashian settled with the SEC, on a NAND basis, for touting EthereumMax ("EMAX") tokens without disclosing that she was paid $250,000 to publish a post on her widely-followed Instagram account about the tokens.

Kardashian's post promoted EMAX's offering (that EMAX had just "burned 400 trillion tokens") and contained a link to EMAX's website, where instructions were provided for potential investors to purchase EMAX tokens.

Though settling a Section 17(b) charge, with an undertaking of not promoting any "crypto asset security" for three years, the Kardashian settlement was remarkable in at least two ways, and presaged the Pierce settlement: (1) notwithstanding the fact that Kardashian posted only one time (albeit she had 225 million Instagram followers) and was cooperating with the SEC, she paid an outsized civil penalty of $1 million dollars — four times the amount of her disgorgement (the highest amount for celebrity crypto touting at that time); and (2) the SEC publicly acknowledged in its press release that she was cooperating with its ongoing investigation concerning EMAX tokens.

The Paul Pierce settlement for crypto violations

Approximately four months after the Kardashian settlement, and approximately a year after a myriad of sports and movie celebrities were pitching crypto on Super Bowl commercials, the SEC announced its first celebrity crypto settlement involving the NBA Hall of Famer Pierce.

According to the February 17, 2023 SEC order, Pierce repeatedly promoted (six times in 10 days) EMAX tokens on his Twitter account without disclosing that he received a large tranche of EMAX tokens (worth about $244,116 at the time he received them) from EMAX.

Pierce also made multiple materially false and misleading statements in his Twitter posts, including how much money he made holding the tokens and how he was holding (and adding) his tokens when he was actually selling them.

Pierce agreed to settle, on an NAND basis, to Section 17(b) and Section 17(a)(2) charges and pay full disgorgement of $244,116 (with prejudgment interest) and civil penalties of $1,150,000. He also agreed to an undertaking of not promoting any "crypto asset security" for three years.

The Pierce settlement, like all other prior celebrity crypto settlements, did not challenge whether the crypto token in question was a "security" under the federal securities laws. But it is otherwise noteworthy for two reasons.

First, the size of the penalty. The SEC assessed a penalty that is more than four times the amount of disgorgement. Perhaps Pierce's violation of the anti-fraud provision made the SEC ratchet up the penalty, but in a case where (presumably) there was no traceable investor loss or tangible harm to the market infrastructure (that is, market manipulation), the penalty amount is a substantial one, for even a well-to-do celebrity individual.

It is also unlikely to be sustained in litigation (if one of these cases were to litigate), even with an SEC-centric application of the *Steadman* penalty factors. Only time will tell whether the SEC will

continue to use this settlement model (the 4X model) for penalties that it has used in the Kardashian and Pierce settlements.

Second, the SEC brought a misrepresentation claim against Pierce in a celebrity crypto touting case. This is a departure from the usual model that the SEC has been using since 2018. No doubt that the SEC would likely have wanted to bring an anti-fraud violation in an appropriate celebrity crypto case for some time.

And the facts alleged in the SEC's order, which appear to be the most flagrant among the cases that the SEC has brought to date, demanded stronger medicine to be prescribed than one just based on touting.

But the SEC settled this case without requiring a more serious scienter-based fraud charge under Section 10(b) of the Securities Exchange Act and/or under Section 17(a)(1) in the settlement, when, arguably, the alleged facts in its order supported such a claim.

Only time will tell whether such a charging decision for the SEC was merely one of avoidance of litigation risk, or whether this settlement will be the new model in a celebrity crypto touting case involving more serious conduct.

But given how many celebrities promoted cryptos on social media in the past few years, we can predict one thing for sure: the Pierce settlement will not be the last one.

Notes

[1] 15 U.S.C. § 77q(b).

[2] *SEC v. Thompson*, 238 F. Supp. 3d 575, 590 (S.D.N.Y. 2017).

[3] *Id*.

[4] *Thompson*, 238 F. Supp. 3d at 595.

[5] *SEC v. Liberty Cap. Grp., Inc.*, 75 F. Supp. 2d 1160, 1161, 1164 (W.D. Wash. 1999).

[6] *United States v. Ware*, 577 F.3d 442, 448 (2d Cir. 2009).

[7] http://bit.ly/3ZBqMl2 (last visited Mar. 10, 2023).

[8] *Id*.

[9] In September 2020, the SEC brought another settled crypto enforcement action involving a rapper and actor, Clifford Harris, Jr., known as "T.I." or "Tip," for promoting an ICO. That administrative case against Harris, however, was not charged under Section 17(b). For full disclosure, I served as senior trial counsel for the SEC on that matter.

About the author

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