

Crypto Enforcement Actions and Litigation Report*

2018

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* Based on Information collected by Bloomberg Law and Morrison Cohen

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The 2017-18 boom and bust in cryptocurrency values and token offerings (so-called initial coin offerings (ICOs)) caused a surge in related enforcement actions and private litigation since late 2017. The field evolved over the course of 2018, with distinct trends emerging in regulatory enforcement actions, criminal enforcement actions, and private litigation by the fourth quarter of 2018.

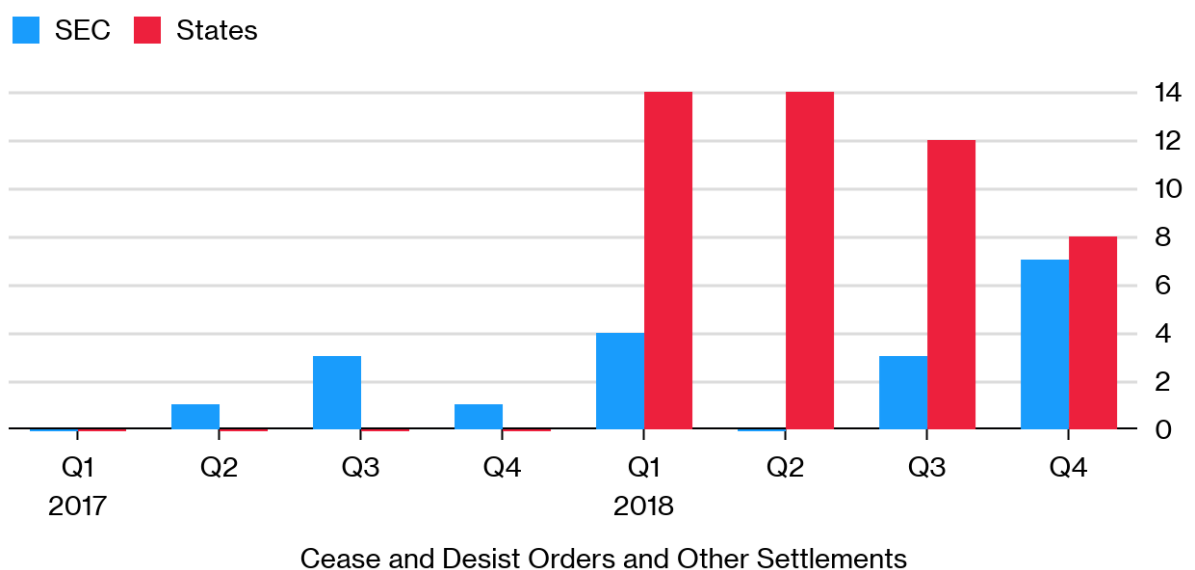
Regulatory Enforcement Actions

Regulatory enforcement actions were brought by the [Securities and Exchange Commission](#) (SEC), [Commodity Futures Trading Commission](#) (CFTC), and numerous state securities regulatory agencies. These various agencies with their differing legal authorities and agendas varied considerably in their enforcement activity in 2017 and 2018.

SEC Chairman Jay Clayton and other SEC officials repeatedly issued warnings from late 2017 to early 2018 of the risks of cryptocurrencies and ICOs and of the SEC's intent to address fraud and other securities law violations. State securities regulators concluded numerous enforcement actions against ICOs in 2018, which in May 2018 Chairman Clayton [applauded](#) and used as a warning that many sets of eyes are watching for frauds.

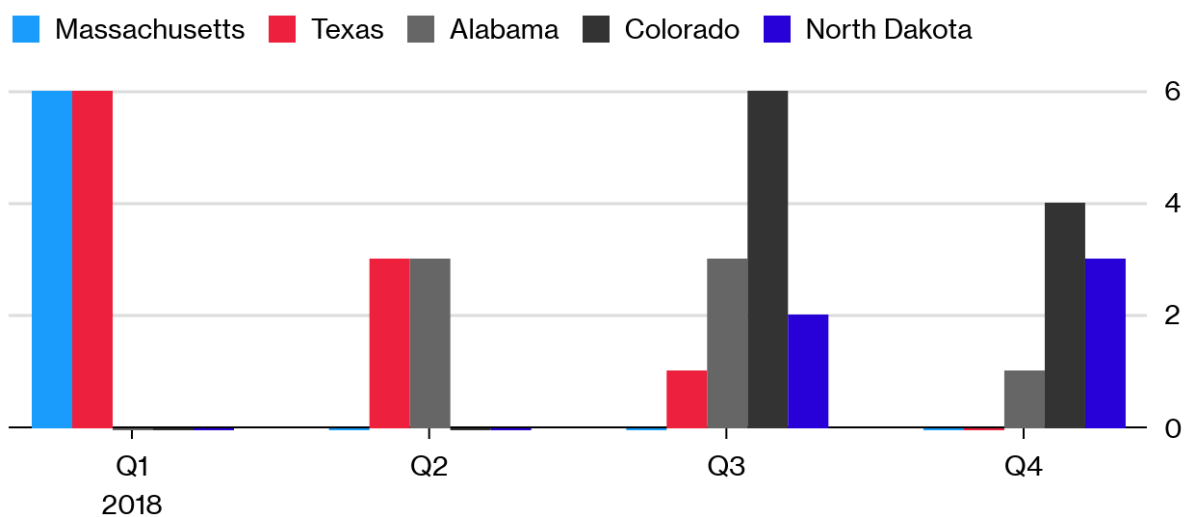
Cease and Desist Orders and Other Settlements

In the fourth quarter of 2018, the SEC stepped up its own enforcement activity against ICOs and other cryptocurrency activity, concluding as many cases as in the rest of the year put together.



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Numerous states also brought actions, but each state's activity level varied over the course of the year. Massachusetts and Texas led in concluding enforcement actions in early 2018, but their activity subsided during the second quarter of the year and ceased after the third quarter. Alabama led the states in number of concluded enforcement actions during the second quarter, followed by Colorado in the third quarter and Colorado and North Dakota in the fourth quarter.



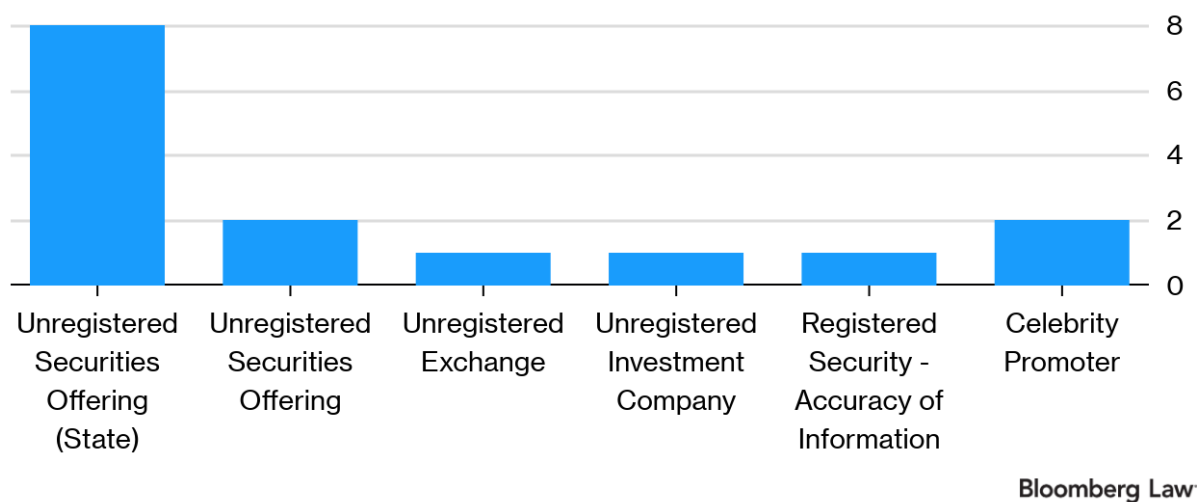
Actions Concluded by the Five Most Active States in 2018

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Violations Cited in Settlements: Q4 2018

The actions concluded in the fourth quarter of 2018 showed that the SEC's concerns extend well beyond fraud and unregistered offerings of securities by ICOs under the much-discussed *Howey* test from the Supreme Court's 1946 decision in [SEC v. W.J. Howey Co.](#) State securities regulators cited token issuers for failures to register securities under state securities laws in all eight actions concluded in the quarter, and the SEC cited unregistered securities offerings in two of its seven actions ([In the Matter of Paragon Coin, Inc.](#), [In the Matter of CarrierEQ, Inc., d/b/a Airfox](#)). The SEC cited other issues in five of its actions:

- Operating an unregistered exchange ([In the Matter of Zachary Coburn](#))
- Operating an unregistered investment company ([In the Matter of CoinAlpha Advisors LLC](#))
- Accuracy and adequacy of information in the marketplace, in the temporary suspension of trading in a registered security ([American Retail Group, Inc.](#))
- Celebrities unlawfully promoting ICOs without disclosing compensation for giving securities publicity ([In the Matter of Khaled Khaled](#), [In the Matter of Floyd Mayweather](#)).

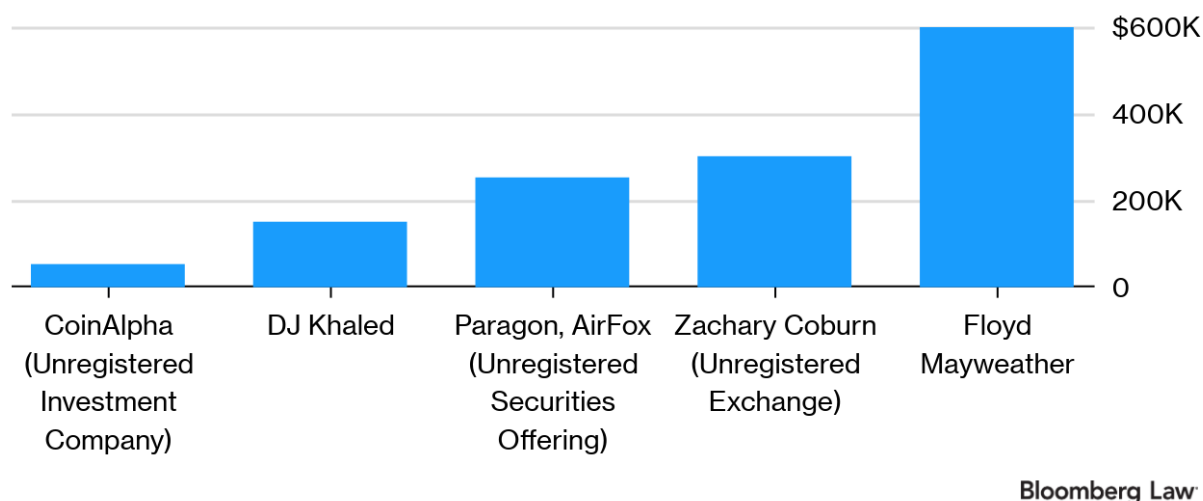


Monetary Penalties: Q4 2018

The monetary penalties that the SEC assessed in these cases provide insight into the seriousness of the violations cited in them. CoinAlpha received a penalty of \$50,000 for operating an unregistered investment company; Paragon and AirFox, penalties of \$250,000 each for unregistered securities offerings; Zachary Coburn, a penalty of \$300,000 for operating an unregistered exchange. Hip-hop star DJ Khaled paid a total of \$150,000, consisting of a penalty of \$100,000 and disgorgement of the \$50,000 undisclosed compensation that he had received.

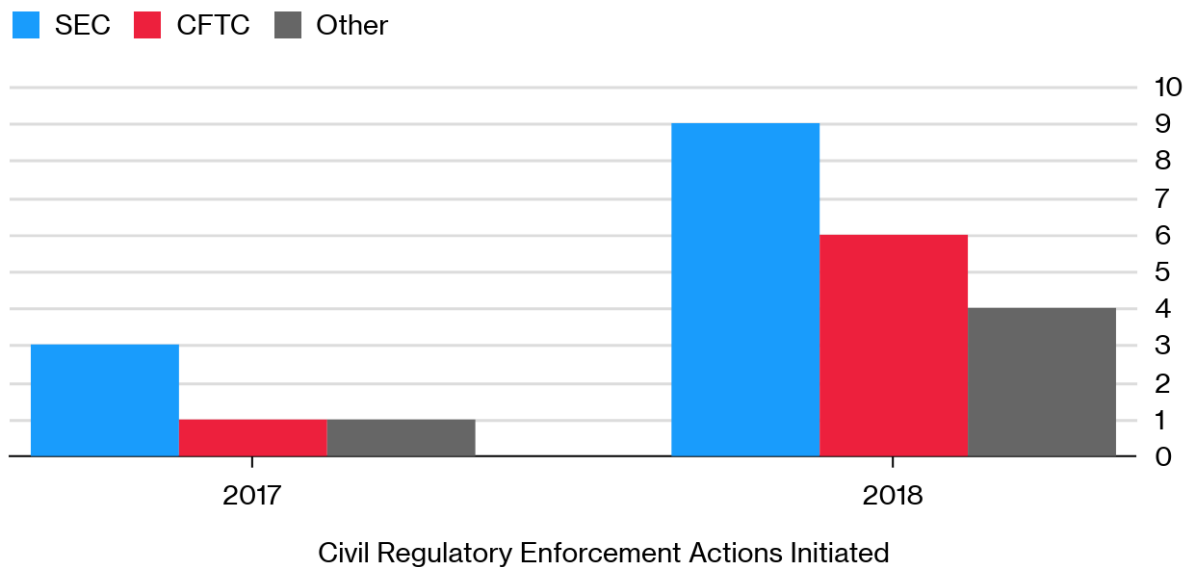
Boxer Floyd Mayweather – whose most-used nickname, appropriately, is “Money” – paid by far the highest amount: \$600,000, consisting of a \$300,000 penalty and a \$300,000 disgorgement. The size of the penalty attests to the potential harm to the public that the SEC saw in

Mayweather's use of his celebrity status to tout ICOs that were unregistered securities offerings in July-September 2017.



Actions in Litigation

The SEC, CFTC, and other federal and state agencies and self-regulatory organizations initiated additional civil enforcement actions that remained unresolved as of the end of 2018. They included [SEC](#) and [CFTC](#) actions simultaneously filed in September 2018 against 1Pool Ltd., for illegally offering and selling securities-based swaps using accounts funded only by Bitcoins, without registering with either the SEC or the CFTC. Other agencies initiating these actions included the Federal Trade Commission, the Financial Regulatory Authority (FINRA), and Colorado Division of Securities. Several of the SEC actions were against the same defendants as in federal criminal enforcement actions. See the section on criminal enforcement actions below.

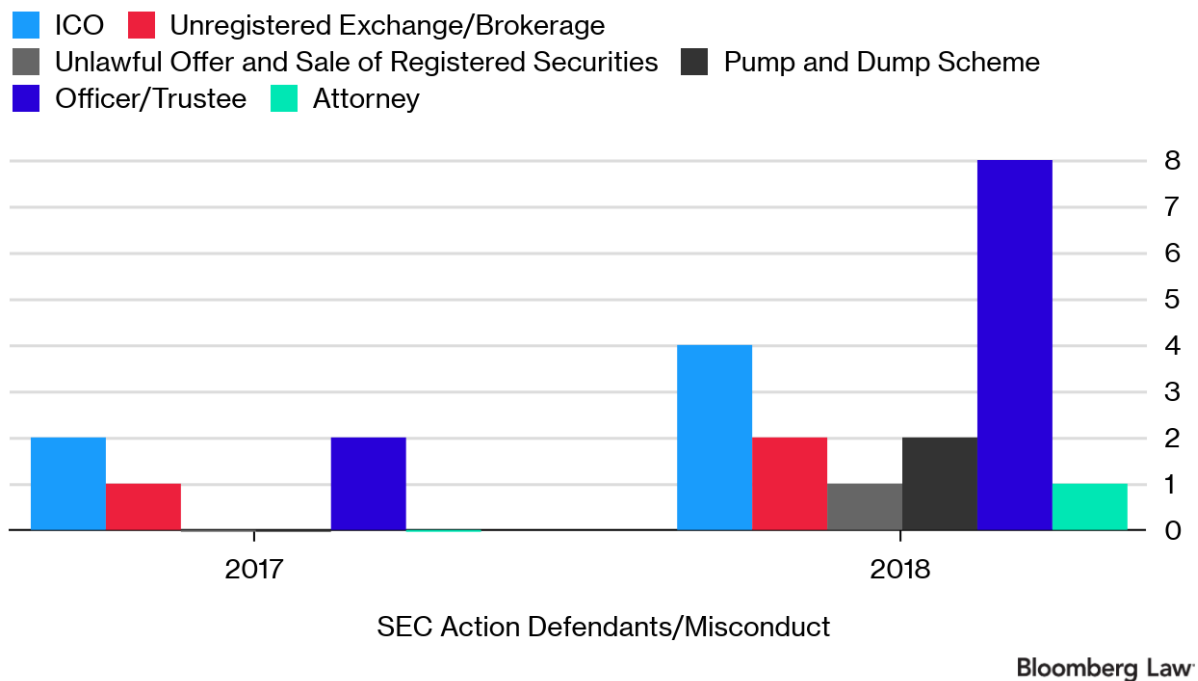


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SEC Enforcement Actions – Misconduct and Defendants

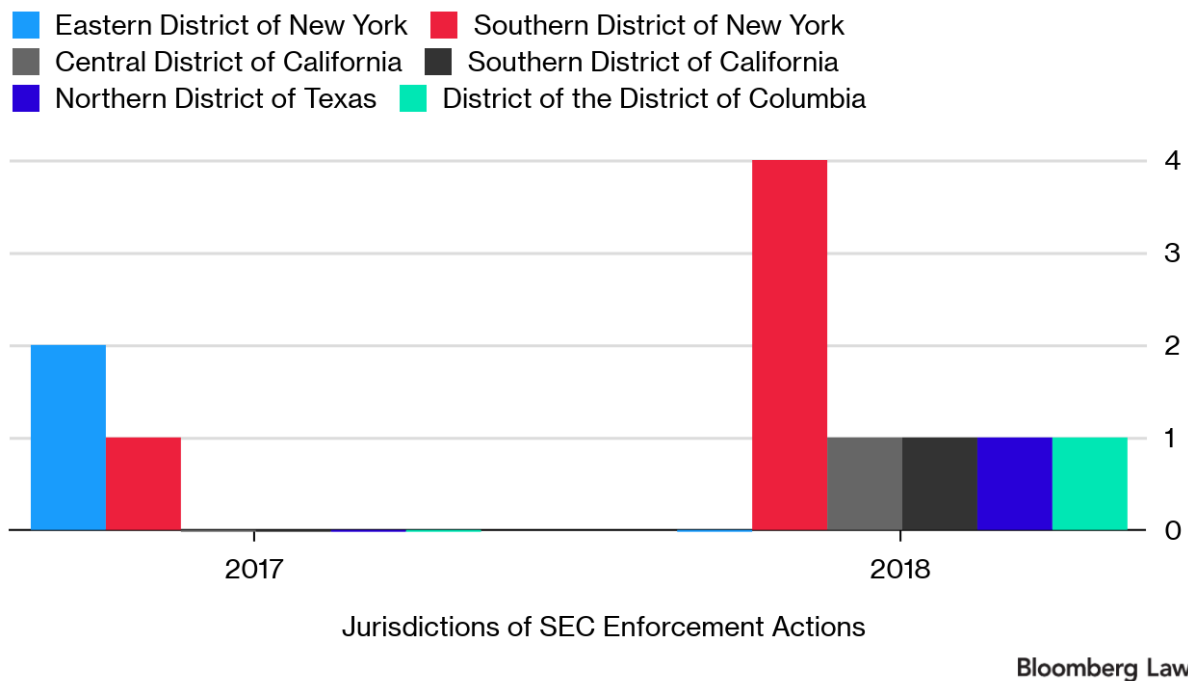
The SEC actions alleged a range of misconduct, some based on offers and sales of unregistered securities in ICOs or operating an unregistered exchange, others alleging unlawful conduct that did not involve actual token sales. ICOs offering and selling unregistered securities were involved in approximately half of the actions, filed approximately once each quarter starting in the third quarter of 2017. Unregistered exchanges were the subjects of several actions starting in the second quarter of 2017. In the third and fourth quarters of 2018, the SEC also filed actions for pump and dump schemes that used claims about blockchain ([SEC v. Saint James Holding and Investment Company Trust and Jeffrey James](#), [SEC v. Barry C. Honig et al.](#)), and an unlawful offer and sale of registered securities of a blockchain company ([SEC v. Jesky et al.](#)).

Most of these SEC actions named as defendants not only the offending companies but also individuals from those companies (e.g. their officers and trustees). One case ([SEC v. Jesky et al.](#)) had only individuals as its defendants, including an attorney, who provided legal services to the company and sold its registered securities unlawfully. SEC Chairman Clayton warned in a December 2017 [speech](#) that many securities lawyers were failing to live up to their responsibilities by advising ICOs violating the securities laws. *Jesky* was not one of those cases, since it involved registered securities rather than an ICO, but it should still be considered a warning to attorneys of the risks of misconduct in representing companies involved with cryptocurrencies and ICOs.



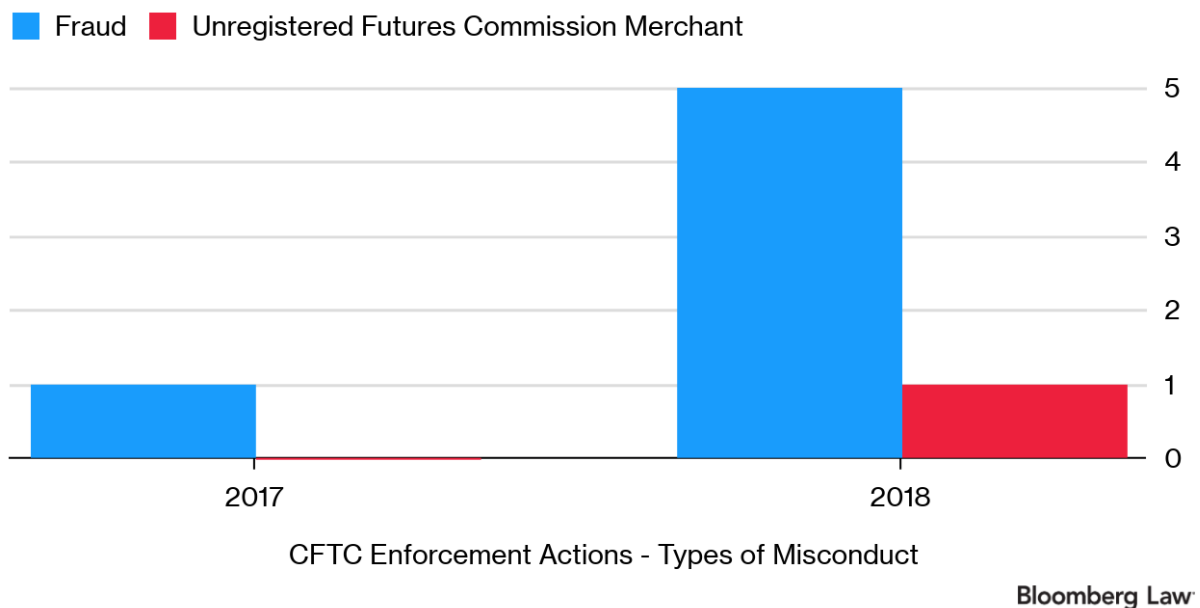
SEC Enforcement Actions – Jurisdictions

New York has been the primary jurisdiction for SEC enforcement actions, with other jurisdictions on an upward trend in 2018. The Southern District of New York and Eastern District of New York have accounted for most of the enforcement actions filed by the SEC since 2017. The Northern District of Texas, Central District of California, District of the District of Columbia, and Southern District of California have seen SEC cases in 2018 as well.



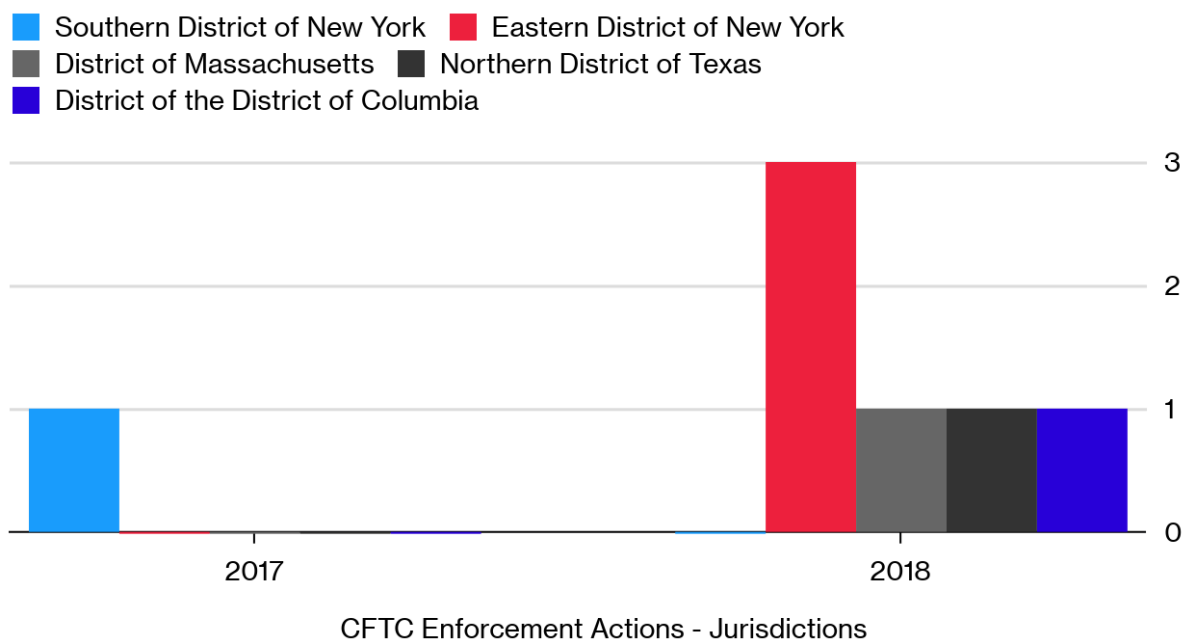
CFTC Enforcement Actions – Misconduct

The CFTC mainly has pursued cases for fraud, but in the [1Pool Ltd.](#) case, filed in September 2018, it has sought to enjoin and penalize an online trading platform for acting as an unregistered futures commission merchant.



CFTC Enforcement Actions – Jurisdictions

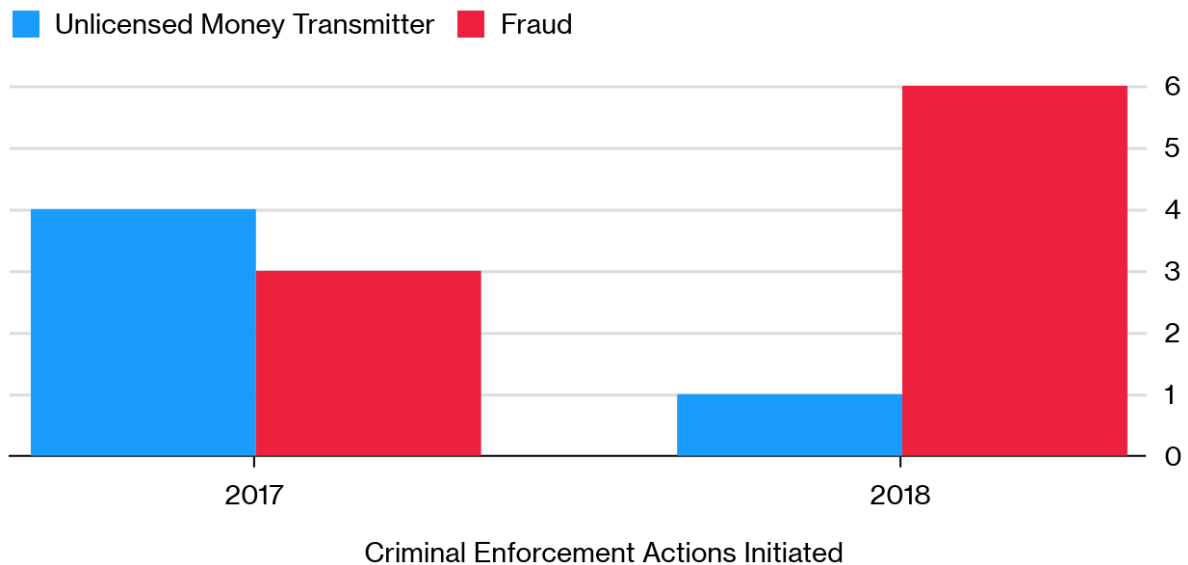
The CFTC has filed its enforcement actions predominantly in the Eastern District of New York, with the Southern District of New York, District of Massachusetts, Northern District of Texas, and District of the District of Columbia seeing CFTC cases as well.



Criminal Enforcement Actions

Misconduct

Criminal enforcement actions involving cryptocurrencies in 2017 and 2018 have prosecuted fraud and unlicensed money transmitters. The [U.S. v. BTC-e and Alexander Vinnik](#) case in January 2017, followed by a Bank Secrecy Act [regulatory enforcement action](#) by the Financial Crimes Enforcement Network (FinCEN) concluded in July 2017, was the first of a series of prosecutions of cryptocurrency-based unlicensed money transmitters. Indictments for fraud followed later in 2017 and peaked in the first and second quarters of 2018. Prosecutions for both fraud and unlicensed money transmission became less frequent during the third and fourth quarters of 2018. The trend may reflect (1) a shift to SEC regulatory enforcement of fraud cases, and (2) the deterrent effect of the 2017 DOJ and FinCEN actions against BTC-e and other actions against cryptocurrency-based unlicensed money transmitters.



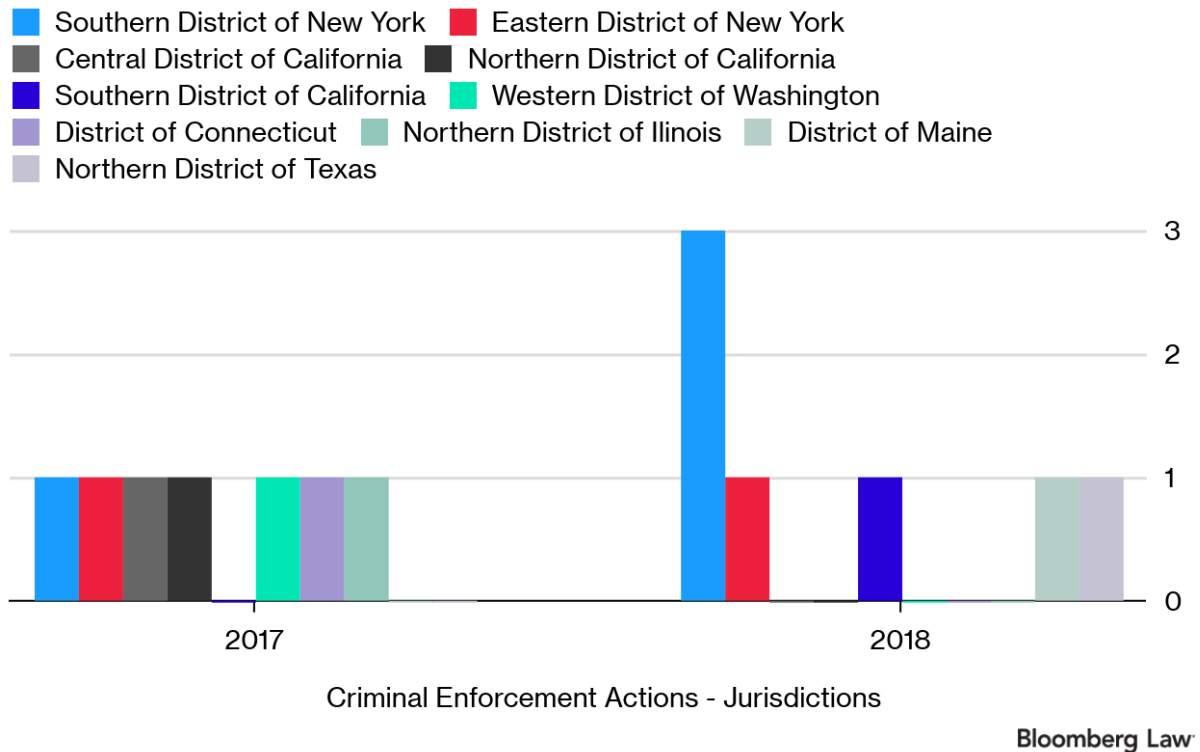
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A number of cases have had parallel regulatory enforcement actions against the same defendants. One such case is that of BTC-e and Alexander Vinnik, which was both indicted by DOJ and subject to a BSA regulatory enforcement action by FinCEN. The fraud cases [U.S. v. Sharma and Farkas](#), filed in March 2018, and [U.S. v. Montroll](#), filed in February 2018, were accompanied by the SEC enforcement actions [SEC v. Sharma and Farkas](#), filed in April 2018, and [SEC v. Montroll and Bitfunder](#), filed in February 2018.

Many of these prosecutions have resulted in guilty pleas, including the fraud cases [U.S. v. Garza](#) and [U.S. v. Kim](#), and the unlicensed money transmitter cases [U.S. v. Ong](#), [U.S. v. Tetley](#), [U.S. v. Mansy and TV TOYZ, LCC](#), and [U.S. v. Campos](#).

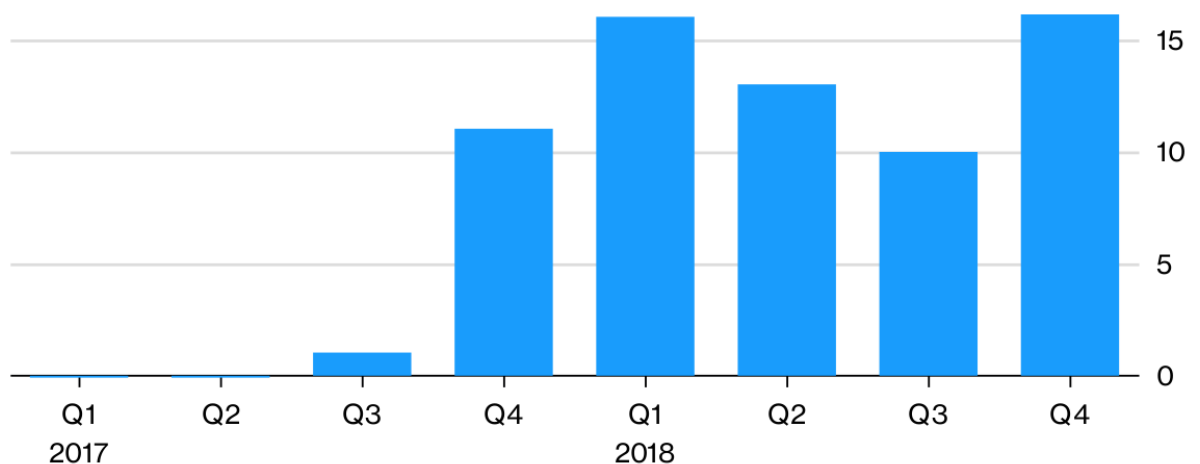
Jurisdictions

The Southern District of New York has been the most frequent jurisdiction for these criminal enforcement actions, with four such actions filed between the second quarter of 2017 and the second quarter of 2018. The Eastern District of New York followed in second place with two filed actions, but other district courts in California, Connecticut, Illinois, Maine, Texas, and Washington have also seen action.



Private Litigation

Class action lawsuits and other private litigation grew at the end of 2017 and continued to be filed at a rate of approximately one action per week in 2018. The sharp rise in cases filed in the fourth quarter of 2017 and the first quarter of 2018 was followed by a slight decrease in the second and third quarters of 2018, but the rate picked up again in the fourth quarter of 2018.

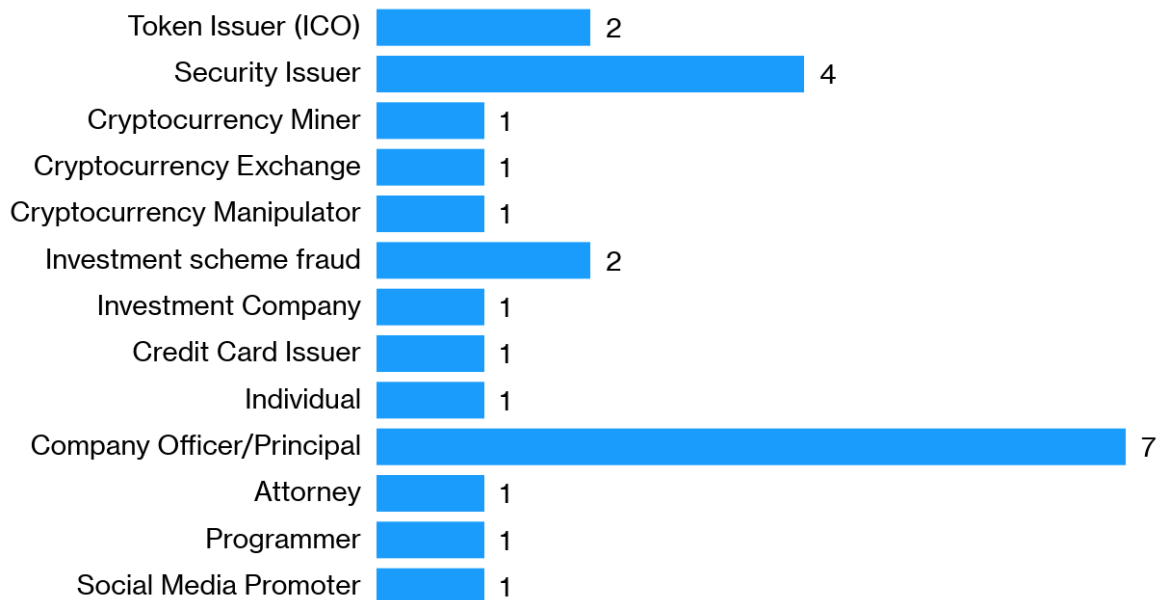


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Types of Defendants

The types of defendants in these lawsuits varied widely. In the 16 lawsuits filed in the fourth quarter of 2018, only two defendants had issued tokens in an ICO ([Corram Holdings, LLC v. Edith A. Pardo Mehler](#), and [In re Giga Watt Inc.](#), a Chapter 11 bankruptcy). Four lawsuits had companies that had issued registered securities as defendants ([Oto v. NVIDIA Corp., et al.](#), [Auctus Fund, LLC and EMA Financial, LLC v. Sunstock, Inc.](#), [Long Chee Min et al v. Longfin Corp. et al.](#), and [Weathersbee v. Meenavalli et al.](#) (with Longfin as a defendant)). Defendants in other cases included a cryptocurrency mining company ([Blockchain Mining Supply and Services Ltd. v. Super Crypto Mining, Inc., and DPW Holdings, Inc.](#)), an investment company ([Lageman, et al. v. Spence, et al.](#)), a cryptocurrency exchange ([United American Corp. v. Bitmain, Inc. et al.](#)), and a credit card issuer ([Galavis v. Bank of America and Visa](#)).

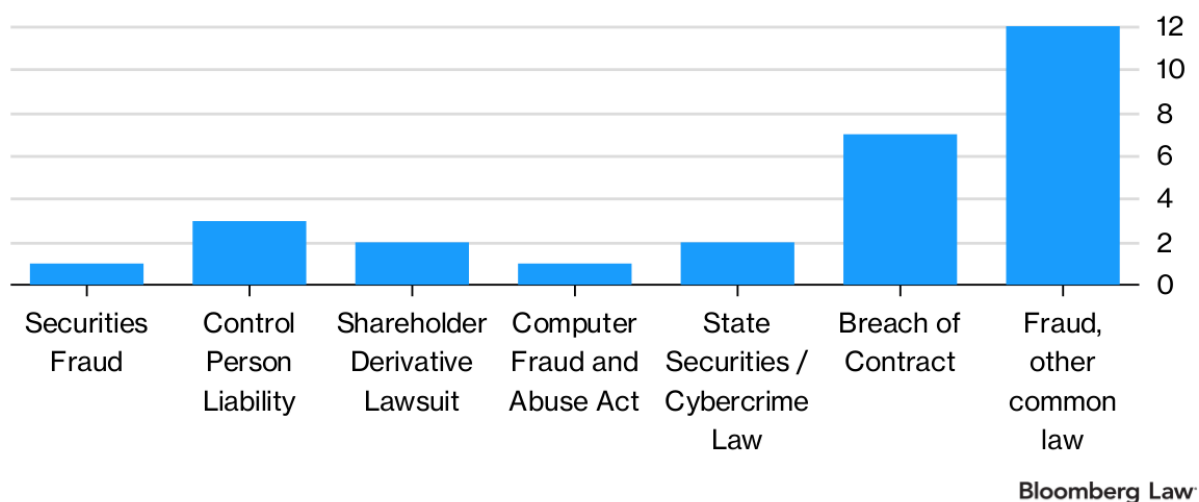
Defendants in several cases consisted of groups or networks of individuals and companies that were engaged in cryptocurrency market manipulation and fraud. A network of individuals and organizations that had a scheme to manipulate the market for Bitcoin Cash composed the defendants in [United American Corp. v. Bitmain, Inc. et al.](#) Investment scheme fraud groups were the defendants in [Schafer, et al. v. Graf, et al.](#) (CryptoCoin Associates LLC) and [Lageman, et al. v. Spence, et al.](#) The latter case included as defendants a social media promoter and a computer programmer, further contributing to the variety of defendants.



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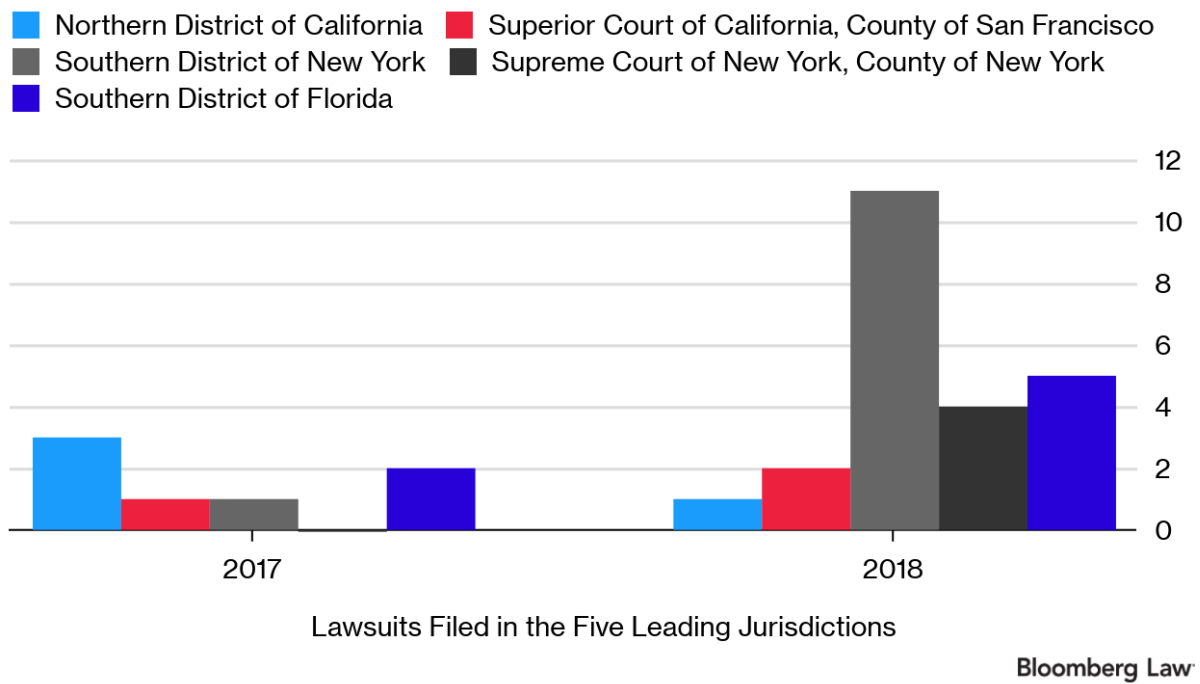
Causes of Action

A wide range of legal bases underpinned these lawsuits. In the fourth quarter of 2018, the most common causes of action ranged from violations of federal and state securities laws and other laws, to fraud and other common law causes of action, with the latter the most common. Of the 16 lawsuits filed, only one alleged securities fraud ([Auctus v. Sunstock](#)), and three alleged control person liability. Two were shareholder derivative lawsuits ([Weathersbee v. Meenavalli et al.](#) (Longfin), [Fintz v. O'Rourke](#) (Riot Blockchain)). Violation of the Computer Fraud and Abuse Act was a cause of action in one other case ([Bitmain v. Doe](#)). State securities laws and cybercrime laws were causes of action in two cases ([Auctus v. Sunstock](#), [Bitmain v. Doe](#)). Breach of contract was alleged in seven lawsuits, and fraud and other common law causes of action were in alleged in 12 cases.



Jurisdictions

Federal and state courts in northern California predominated as the venues for cases during the initial rise of litigation in late 2017, but federal and state courts in New York became more commonly used in 2018. The Northern District of California and the Superior Court of California, County of San Francisco accounted for the majority of cases filed in the fourth quarter of 2017, ahead of the Southern District of Florida and the Southern District of New York. The Southern District of New York and the Supreme Court of New York, County of New York became far more frequently used starting in the second quarter of 2018 and continuing to the end of the year.



For more information on U.S. and international developments affecting ICOs and the blockchain sector go to the Bloomberg Law [ICO Developments Tracker](#) and the [In Focus: Blockchain](#) page. For additional information on crypto litigation, go to the Morrison Cohen [MoCo Cryptocurrency Litigation Tracker](#).