

The landscape of government enforcement, private litigation and federal and state regulation of digital assets, blockchain and related technologies is constantly evolving. Each quarter, Ropes & Gray attorneys analyze government enforcement and private litigation actions, rulings, settlements and other key developments in this space. We distill the flood of industry headlines so that you can identify and manage risk more effectively. Below are the takeaways from this quarter’s review.

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Enforcement Landscape

SEC and CFTC enforcement focus confirmed by year-end statistics. In the fourth quarter of 2023, both the U.S. Securities and Exchange Commission (“SEC”) and the Commodity Futures Trading Commission (“CFTC”) continued to bring enforcement actions in the crypto space. In fact, on November 7, 2023, the CFTC unveiled its fiscal year 2023 [enforcement statistics](#), which showed an increased focus on digital assets since last year: nearly 50 percent of the CFTC’s enforcement actions in FY23 involved digital assets, up from just 20 percent in FY22. In its 2023 [enforcement results](#) issued on November 14, 2023, the SEC similarly trumpeted its enforcement activity relating to digital assets, such as fraud, unregistered offerings, unregistered exchanges and illegal touting.

1. Binance and Its Executives Reach Historic Settlement with Enforcement Authorities

In our [Q2 2023 newsletter](#), we discussed the CFTC and SEC’s landmark charges against Binance, the world’s largest

digital asset exchange. This quarter, one chapter of the Binance saga comes to a close with several high-profile settlement agreements.

- On November 21, 2023, a number of enforcement authorities reached a record-breaking coordinated resolution with Changpeng “CZ” Zhao, and Zhao’s companies Binance Holdings Limited, Binance Holdings (IE) Limited, and Binance (Services) Holdings Limited (collectively “Binance”) in an effort led by the Department of Justice (“DOJ”). In November 2023, the DOJ unsealed long-awaited charges against [Zhao](#) and [Binance](#) for violations of U.S. sanctions law, the anti-money laundering provisions of the Bank Secrecy Act, and more.
- A week after the charges were unsealed, Binance reached a \$4.3 billion [resolution](#) with the DOJ, the U.S. Department of the Treasury (through the Financial Crimes Enforcement Network (“FinCEN”) and the Office of Foreign Assets Control (“OFAC”)), and the CFTC (the SEC was notably absent from the line-up). The \$4.3 billion settlement is one of the largest corporate penalties ever levied (the largest in U.S. Treasury history).
- The DOJ’s settlement agreement resolves allegations that Binance failed to implement controls and procedures to prevent money laundering, such as “Know Your Customer” (“KYC”) and monitoring procedures, and failed to prevent U.S. customers from conducting transactions with customers in sanctioned jurisdictions, despite knowledge that Binance was used by illicit actors to facilitate money laundering and that users from sanctioned jurisdictions used the platform and transacted with U.S. customers. Pursuant to the settlement, Binance will forfeit \$2.5 billion and pay a criminal fine of \$1.8 billion.

- The settlement agreements with FinCEN and OFAC resolve alleged violations of the Bank Secrecy Act, including failure to implement programs to prevent and report suspicious transactions, and sanctions violations. FinCEN's settlement agreement assesses a civil money penalty of \$3.4 billion, and OFAC's settlement agreement assesses a penalty of \$968 million.
 - In addition to monetary penalties and forfeitures, the DOJ, FinCEN and OFAC settlements notably impose two separate independent compliance monitors to oversee significant compliance undertakings. The DOJ settlement agreement mandates a three-year monitorship, while the FinCEN settlement agreement mandates a five-year monitorship (full compliance with which is separately required by the OFAC settlement agreement).
 - With respect to the [CFTC](#), a proposed consent order would settle the CFTC's charges that Zhao and Binance had operated an illegal digital assets derivative exchange and knowingly disregarded provisions of the Commodity Exchange Act ("CEA"). The order would require Binance to disgorge \$1.35 billion and pay a \$1.35 billion civil penalty, and it would require Zhao to pay a \$150 million civil penalty. The order further would permanently enjoin Zhao and Binance from willfully evading the CEA, acting as an unregistered futures commission merchant, operating an illegal digital asset derivatives exchange, and failing to impose adequate KYC compliance systems.
 - The same day, the [CFTC announced](#) that Samuel Lim, Binance's former Chief Compliance Officer, had also agreed to a proposed consent order. The order would permanently enjoin Lim from willfully evading the CEA, require Lim to pay a \$1.5 million civil penalty, and impose the same injunctive relief described above.
 - On December 18, 2023, the United States District Court for the Northern District of Illinois [approved](#) the CFTC settlement, bringing the CFTC's enforcement to a close. But Binance is not out of the woods yet; the SEC was [not part of the settlement](#) and is prosecuting its own enforcement action in the U.S. District Court for the District of Columbia.
- ## 2. Other SEC And CFTC Enforcement Actions
- **SEC targets "astronomical" fraud scheme.** On November 1, 2023, the [SEC filed](#) a complaint against SafeMoon LLC, its founder, and several executive officers in the U.S. District Court for the Eastern District of New York for fraud and failure to register with the SEC in connection with the unregistered sale of its token, SafeMoon. The SEC's complaint alleges that, although the defendants promised investors that their funds were safe in SafeMoon's liquidity pool, the defendants misappropriated at least \$200 million of investor assets for personal uses, such as funding luxury cars and extravagant vacations.
 - **SEC goes after major crypto exchange (again).** On November 20, 2023, the [SEC charged](#) Payward Inc. and Payward Ventures—which do business as Kraken—in the U.S. District Court for the Northern District of California for violating registration provisions imposed on securities exchanges, brokers, dealers and clearing agencies. The complaint alleges that Kraken's failures have deprived investors of significant protections, including inspection by the SEC, recordkeeping requirements, and safeguards against conflicts of interest. The SEC's complaint also alleges that Kraken's business practices, internal controls, and poor recordkeeping practices present risks to its customers.
 - Recall that, in our [Q1 2023 newsletter](#), we reported that Kraken settled charges brought by the SEC which alleged that Kraken had failed to register the offer and sale of its crypto asset staking-as-a-service program.
 - **SEC action showcases DAO decision-making.** On December 22, 2023, the [SEC announced](#) two cease-and-desist orders reached with Barnbridge DAO, a "decentralized autonomous organization," and its founders, settling charges that they offered and sold Smart Yield Bonds without filing an associated registration statement. Investors could purchase these Smart Yield Bonds through BarnBridge's website, and Smart Yield would purportedly pool investors' crypto assets to generate returns for investors. Investors had invested more than \$509 million in Smart Yield. Pursuant to the orders, Barnbridge agreed to disgorge sale proceeds and the founders agreed to pay civil penalties.
 - This action may be the first where DAO members held a vote on how to respond to an enforcement action. DAOs don't have centralized leadership, rather, decisions are made using tokens that grant voting powers. Admission is limited to people who have confirmed ownership of these governance tokens in a cryptocurrency wallet, and membership may be exchanged.
 - **CFTC brings fraud and registration failure complaint against former Voyager Digital CEO.** On October 12, 2023, the [CFTC filed](#) a complaint against Stephen Ehrlich, the former chief executive officer of Voyager Digital Ltd., Voyager Digital Holdings, Inc., and Voyager Digital, LLC (collectively "Voyager"). Voyager, which declared bankruptcy in July 2022, was a digital asset platform touted as a "safe haven" for customers' digital assets in an otherwise volatile market. Ehrlich and Voyager also promised that Voyager would offer the "same level of rigor and trust" as a traditional banking institution and promised returns as high as 12% on customer assets stored on the platform. According to the CFTC, to achieve these returns, Ehrlich and Voyager pooled customer funds and made billions of dollars in high-risk loans to third parties. In so doing, the CFTC charged, Voyager allegedly operated as an unregistered commodity pool operator.

- **CFTC wins default judgment against “pig butchering” scheme participants.** In our [Q3 2023 newsletter](#), we covered the CFTC’s filing of a complaint against Cunwen Zhu and Justby International Auctions in the U.S. District Court for the Central District of California, alleging that Zhu and Justby fraudulently misappropriated over \$1.3 million through a “pig butchering” scheme. On December 20, 2023, the court entered a default judgment against Zhu and Justby. The order permanently enjoins the defendants from registering with the CFTC or participating in any CFTC-regulated markets. The defendants were also ordered to pay a \$4 million civil penalty and over \$1.3 million in restitution. This is the CFTC’s first [successful enforcement action](#) against perpetrators of such a scheme.

3. DOJ Secures High-Profile Pleas and Verdicts

The DOJ has also secured guilty pleas and verdicts in several high-profile criminal enforcement actions against former crypto exchange executives. For example, criminal charges against crypto exchange founders and erstwhile CEOs made headlines in the last quarter of 2023. In November alone, the DOJ [“successfully prosecuted](#) the CEOs of two of the world’s largest cryptocurrency exchanges in two separate criminal cases.” [Per Attorney General Merrick Garland](#) “[t]he message here should be clear: using new technology to break the law does not make you a disruptor, it makes you a criminal.”

- **Federal jury finds FTX founder SBF guilty on all counts.** On November 2, 2023, a federal jury found Sam Bankman-Fried (commonly referred to as simply “SBF”) guilty of seven counts of fraud, conspiracy, and money laundering in a case heard before Judge Lewis Kaplan in the U.S. District Court for the Southern District of New York. The verdict came just under a year after FTX’s dramatic fall from grace in November of 2022.
 - The unanimous verdict stems from Bankman-Fried’s conduct as then-CEO of FTX, the world’s largest cryptocurrency exchange at the time. Bankman-Fried misappropriated billions of dollars of customer funds and defrauded lenders by illegally transferring assets held by FTX to Bankman-Fried’s cryptocurrency trading firm Alameda Research. Sentencing is scheduled for March 28, 2024.
 - A second trial for his alleged bank fraud, campaign finance violations, and Foreign Corrupt Practices Act violations was scheduled for March 24, 2024. Prosecutors [dropped these charges](#) on December 29, stating in their motion that the Bahamas had not granted its consent for a trial on the remaining charges, which may delay the victims’ relief.
- **Founder of Hong Kong-based Bitzlato pleads guilty.** Anatoly Legkodymov, founder and majority owner of Hong Kong-based exchange Bitzlato, [pled guilty](#) to processing more than \$700 million of illicit funds

through his company in December. The plea deal requires Legkodymov to dissolve Bitzlato and release any claim over the \$23 million in assets already seized. The takedown of Bitzlato was a cooperation between the U.S., France, and the European Union’s law enforcement agency, Europol.

- **Former Binance CEO CZ ordered to remain in U.S. pending sentencing.** The record-breaking Binance settlement discussed above is also the [largest](#) settlement to include criminal charges against an executive. CZ, who was forced to step down as CEO (but who retains his controlling stake in the company), may face up to 10 years in prison as part of the deal. In December, Judge Richard Jones of the U.S. District Court for the Western District of Washington granted the prosecutors’ requests to order CZ to remain in the U.S. until his February 23 hearing. CZ was deemed a flight risk because of his multi-billion dollar net worth, lack of connections to the U.S., and citizenship in the UAE—which does not have an extradition treaty with the U.S.

4. DOJ Tackles Scammers and “Pig Butchering” Schemes

- **Tether freezes over \$1 billion in assets in cooperation with the DOJ and international agencies.** According to a press release, Tether [voluntarily froze](#) \$225 million in Tether tokens (“USDT”) linked to an “international trafficking syndicate in Southeast Asia responsible for a global ‘pig butchering’ romance scam.”
 - “Pig butchering” is low-tech but labor-intensive, and [human traffickers have stepped in](#) to supply scammers with a captive workforce who are forced to execute the scam. This comes after Tether [froze \\$835 million of assets](#) associated with crimes in 19 jurisdictions, largely theft and a small amount (just over one percent) of terrorist financing.
 - Tether pushed back on calls by two U.S. congress-people for a DOJ investigation, [stating in a press release](#) that “[t]here is simply no evidence that Tether has violated sanctions laws or the Bank Secrecy Act through inadequate customer due diligence or screening practices.”
 - In connection with Tether’s self-seizure, the [DOJ announced](#) its own seizure of nearly \$9 million worth of USDT that was traced to cryptocurrency addresses allegedly associated with the organization perpetrating the scheme. According to the announcement, agents and analysts from the U.S. Secret Service traced victims’ deposits and observed rapid laundering of the funds through a method known as “chain hopping,” in which funds are laundered through several cryptocurrency addresses and exchanged for different types of cryptocurrencies.

5. U.S. Treasury's OFAC Settles Major Charges

- In addition to the historic Binance settlement described above, on December 13, 2023 [CoinList Markets LLC](#) ("Coinlist") settled charges with OFAC for allegedly violating OFAC's sanctions against Russia/Ukraine by allowing Russian users posing as Crimean residents to open accounts on its platform. According to OFAC's [enforcement release](#), Coinlist's KYC measures were insufficient to properly identify the correct region in which users purportedly lived. The allegedly deficient KYC measures resulted in 89 accounts which were opened in sanctioned regions. Coinlist settled these charges for over \$1 million.

6. N.Y. Attorney General's Crypto Enforcement Campaign Shows No Signs of Slowing

- **Digital Currency Group, Genesis Global, and Gemini Trust gear up to fight fraud claims brought by New York Attorney General ("NYAG").** Digital Currency Group, its bankrupt subsidiary Genesis Global, and cryptocurrency exchange Gemini Trust Co. were each accused of misrepresentation to investors and customers, which allegedly resulted in \$1.1 billion in losses and the collapse of the Gemini Earn program. Recall that the Gemini Earn program enabled Gemini account holders to loan their cryptocurrency to Genesis Global in exchange for an interest payment.
 - Genesis Global and its parent company, Digital Currency Group, were accused of hiding its \$1.1 billion losses from the public and lying to Gemini Trust when Genesis Global's financial standing worsened. Moreover, Gemini Trust was accused of defrauding investors by marketing the Gemini Earn program as "low risk," when its own internal assessments indicated that Genesis Global was a much higher risk profile due to Genesis Global's undersecured loans to counterparties.
 - The NYAG aims to ban the companies from operating securities or commodities businesses in New York state. We will continue to follow updates on this lawsuit as it progresses.
- **KuCoin, one of the largest and most popular cryptocurrency exchanges, agreed to pay \$22 million in fines and refunds and to stop trading in New York to resolve a lawsuit by the state.** In December, the NYAG reported a \$22 million [settlement](#) with Seychelles-based cryptocurrency exchange KuCoin. The NYAG sued KuCoin in March 2023, accusing the exchange of allowing New York customers to trade cryptocurrencies on its platform without registering as a securities and commodities broker-dealer and for falsely representing itself as a crypto exchange. KuCoin will refund \$16.77 million to New York customers and pay \$5.3 million to the NYAG's office. KuCoin must also cease operations in New York State, meaning it is prohibited from creating accounts for New York customers and must prevent New Yorkers from accessing the exchange.

Regulatory Updates

1. U.S. Treasury's FinCEN Eyes Increased Recordkeeping and Reporting

- **FinCEN issued a [notice of proposed rulemaking](#)** to designate the category of transactions known as convertible virtual currency ("CVC") mixing as a class of transactions of "primary money laundering concern." Under Section 311 of the USA PATRIOT Act, the Treasury is authorized to take measures to target money laundering and terrorist financing risks, including determining that a foreign jurisdiction, institution, class of transaction, or type of account is of "primary money laundering concern." This designation enables the Treasury to require domestic financial institutions and financial agencies to undertake certain measures relating to transactions. This proposed rule would increase covered financial institutions' reporting and recordkeeping requirements relating to transactions that involve CVC mixing.
 - Notably, this is the first time FinCEN has used Section 311 to target a class of transactions instead of a specific entity or jurisdiction. In its announcement, FinCEN highlighted that the proposed rule seeks to enhance transparency in CVC mixing and target its use by illicit actors. The Treasury has repeatedly voiced its concern that CVC mixing enables money laundering and terrorist financing by concealing the source, destination or amount involved in a transaction.
 - The proposed rule comes on the heels of a flurry of undertakings by the Treasury to target illicit finance in the cryptocurrency space. For example, OFAC has designated several entities that offered mixing services (e.g., Blender.io, Tornado Cash) and FinCEN has designated cryptocurrency exchanges, such as Bitzlato, as a "primary money laundering concern." The Treasury may be gaining momentum—at the November 2023 Blockchain Association's Policy Summit in Washington D.C., Deputy Secretary of the Treasury Wally Adeyemo revealed that the agency has asked Congress to expand its surveillance and enforcement powers under the Bank Secrecy Act: "We need to update our illicit finance authorities to match the challenges we face today, including those presented by the evolving digital asset ecosystem[.]"

2. Consumer Financial Protection Bureau ("CFPB") Seeks to Extend its Oversight to Digital Wallet Providers

- In November 2023, the CFPB issued a [notice of proposed rulemaking](#) that would enable the agency to expand its enforcement authority over nonbank providers of financial services. While the CFPB currently retains enforcement authority over digital wallets and payment apps, the proposed rule would authorize the Bureau to "supervise" their providers. The proposed rule aims to subject fintech providers to the same supervisory activities as banks, such

as on-site examinations, policies and procedures assessments, transaction and account testing, management and recordkeeping evaluations, and assessments of compliance with federal consumer financial laws. The rule would only apply to companies that the CFPB defines as “larger participants.” The proposed threshold is companies that process five million transactions in a year (including affiliated companies) that are not considered small businesses by the Small Business Administration.

3. New York’s Department of Financial Services (“NYDFS”) Beefs Up Standards for Coin-Listing and Delisting

- NYDFS finalized its guidance regarding New York State’s digital currency regulatory regime, **BitLicense**. The [guidance](#), Guidance Regarding Listing of Virtual Currencies, was proposed in September 2023 and sets heightened standards for virtual currency coin listing and de-listing for all Virtual Currency (“VC”) business under the regulatory program. VC businesses must submit and receive approval for both coin listing and delisting policies that meet the standards set forth in the newly issued guidance before they can self-certify any coins. In addition, VC business are required to perform comprehensive risk assessments of new coins.

Private Litigation

1. Continued Fallout from Gemini Earn And Celsius Bankruptcies

- Digital Currency Group agreed to pay \$275 million in settlement with subsidiary, Genesis Global Holdco. Digital Currency Group reached the settlement with Genesis Global after [it was sued for the wrongful possession of loans](#) worth \$620 million in September 2023. The lawsuit is related to Genesis Global’s ongoing bankruptcy proceedings, and includes a \$35 million upfront payment and a \$10 million holdback from the sale of CoinDesk, a media company previously owned by Digital Currency Group. Digital Currency Group already paid \$227.3 million of its loans to Genesis Global. The current settlement plan is still subject to approval by creditors.
 - While the settlement does not completely cover Digital Currency Group’s debt to Genesis Global, it represents a significant step towards avoiding a lengthy and costly legal battle. Digital Currency Group is a venture capital firm that invests in digital asset companies and blockchain. Genesis Global, a leading cryptocurrency lending firm, [filed for bankruptcy in early 2023](#).

2. Bankruptcy Rulings’ Outsized Influence on Crypto

- Bankruptcy judges demonstrate outsized influence on cryptocurrency exchanges and digital currency amid wave of Chapter 11 bankruptcy proceedings. Celsius is

not the only major crypto exchange to weather the storms of bankruptcy. In the wake of the dramatic collapse of Celsius and other major cryptocurrency exchanges, such as FTX and Voyager Digital Holdings, some [experts claim](#) this “crypto winter” turned many bankruptcy judges into de-facto crypto regulators.

- Some proponents of this approach note the benefits of Chapter 11 proceedings. For example, Chapter 11 is a mostly transparent process in which debtors divulge balance sheets, creditor lists, and more. Bankruptcy proceedings have been known to reveal wrongdoing through investigations faster than prosecutors can, provide a venue for regulators to weigh in on restructuring plans, and define key legal issues. However, some critics claim bankruptcy courts are not always well-suited to cryptocurrency regulation.
- For example, one November ruling by Bankruptcy Judge Martin Glenn in U.S. District Court for the Southern District of New York determined that crypto assets in Celsius’ “Earn accounts” belonged to Celsius, not to the customers who deposited them. Judge Glenn’s ruling effectively transformed customers to unsecured creditors, harming customers’ prospects of recovering the value of their cryptocurrency.
- Ropes & Gray’s Daniel Gwen and Melissa C. Bender provide more context for the Celsius case and the implications of its bankruptcy proceedings [here](#).

3. Accusations of Fraud, Misfeasance and Improper Data Collection

- Cristiano Ronaldo accused of selling NFTs as “unregistered securities.” In [Sizemore et al. v. Ronaldo](#), No. [1:23-cv-24481](#), (S.D. Fla., filed Nov. 27, 2023), lead plaintiffs Michael Sizemore, Mikey Vongdara, and Gordon Lewis claim that Ronaldo’s “misrepresentations and omissions” caused them to buy “unregistered securities from Binance.”
 - The complaint alleges that Ronaldo launched a commercial campaign to sell non-fungible tokens (“NFTs”), leading to “a 500% increase in searches using the keyword ‘Binance.’” But plaintiffs allege that these NFTs were unregistered securities, resulting in substantial financial losses for investors. For example, the price of Ronaldo’s NFTs in November 2022 ranged from \$77 to \$23,000, but just a year later, many are worth only \$1.
 - The suit against Ronaldo is the latest in a series of lawsuits against celebrities and prominent organizations, such as Kim Kardashian and Major League Baseball, for their endorsement of defunct crypto trading platforms.

- Crypto lending platform Block Assets LLC accused of operating a Ponzi scheme and violating the Racketeer Influenced and Corrupt Organizations Act (“RICO”). Block Assets, which operates Blockas, advertises that it does not

charge fees for its services. But when Plaintiff Michael Lynn Gabriel directed Blockas to wire \$2.5 million to his Bank of America account (originally in bitcoin then converted to cash), Blockas asked him to pay \$5,000 in bitcoin to prepare paperwork for the IRS to complete the wire transfer.

- After Blockas received the \$5,000, it informed Gabriel that the wire transfer failed and they he would have to open a digital investment account with a brokerage to wire transfer his funds.
- In [Gabriel v. Block Assets LLC](#), No. 3:23-cv-06204 (N.D. Cal., filed Nov. 30, 2023), Gabriel alleges that many clients have “repeatedly” made similar complaints on the internet, and that the platform’s conduct amounts to embezzlement, theft, and conversion of client funds. Gabriel’s lawsuit also brings claims for breach of contract, unjust enrichment, and fraud.
- **Coinbase asks New Jersey federal judge to dismiss investor suit over SEC probe.** In *In re Coinbase Global, Inc. Sec. Litig.*, No. 2:22-cv-04915 (D.N.J., filed Dec. 21, 2023), Coinbase [moved to dismiss](#) an investor suit that, Coinbase alleges, is using the SEC enforcement action against Coinbase as a basis to show securities fraud. Coinbase claims that the SEC investigation reflects an overly expansive view of the securities laws and that investors are “working backwards from stock price drops in search of a theory of fraud.” In response, Plaintiff investors take the position that Coinbase was listing assets that its own review process flagged as “likely securities,” and that the SEC had affirmatively told Coinbase that most assets on Coinbase’s platform were securities.
- **Cryptocurrency markets face Biometric Information Data Act (“BIPA”) violations in Illinois.** Blockchain.com and Moonpay, two popular cryptocurrency exchanges, allegedly collect geometric facial scans to verify user identities without providing necessary disclosures regarding data collection and obtaining user consent. Lead plaintiff Candice Wilhelm seeks statutory damages of \$1,000 for every negligent BIPA violation and \$5,000 for every willful violation. [Wilhelm v. Blockchain \(US\) LLC](#), No. 2023-CH-09544 (Ill. Cir. Ct. Chancery Div., filed Nov. 20, 2023); [Wilhelm v. Moonpay USA LLC](#), No. 2023-CH-09544 (Ill. Cir. Ct. Chancery Div., filed Nov. 20, 2023).

4. Continued Private Litigation—Are Digital Assets Securities?

Although many attention-grabbing lawsuits exploring *Howey*’s parameters take place in an enforcement context, there are several lawsuits considering this important question in private-plaintiff litigation as well. Plaintiffs have alleged that various digital assets—from NFTs to cryptocurrencies—are “investment contracts” under *Howey*, and are seeking relief for alleged violations of securities laws.

- **Massachusetts federal judge to decide whether DraftKings’ NFTs are “securities.”** In December, U.S.

District Judge Denise J. Casper heard argument on a [motion to dismiss](#) addressing whether NFTs are “securities” under *Howey*. We have summarized [Dufoe v. DraftKings Inc. et al.](#), No. 1:23-cv-10524 (D. Mass., filed Mar. 9, 2023) and other class action lawsuits in [previous issues](#) of the Crypto Quarterly.

- Recall that plaintiff Justin Dufoe claims that he lost \$14,000 buying and selling NFTs on DraftKings’ platform. Dufoe argues that DraftKings’ NFT marketplace effectively mirrors the stock market and that DraftKings exerts influence on the value of NFTs by building an “ecosystem” for buying and trading them.
- In contrast, DraftKings argues that NFTs have their own intrinsic value as collectibles and do not behave like securities, which would otherwise entitle the investor to share in DraftKings’ profits. We will continue to provide notable updates in the *DraftKings* litigation and similar NFT cases in future issues.
- **Coinbase will fight the SEC’s decision not to clarify its position on digital asset sector.** On December 15, 2023, the SEC denied Coinbase’s rulemaking petition asking that the Commission clarify its guidelines for whether digital assets are considered securities. The SEC’s 3-2 ruling confirmed that it would not propose new rules because it did not believe that current regulations under *Howey* are “unworkable” in the digital asset sector. That same day, Coinbase announced that it would seek relief in federal court and filed [another petition](#) for review in the U.S. Court of Appeals for the Third Circuit.
 - This is the latest move in a series of legal battles between the SEC and Coinbase. Recall that Coinbase initially filed its petition with the SEC in 2022, arguing that the current U.S. securities laws are inadequate to govern cryptocurrency. Coinbase then appealed to the Third Circuit in April, seeking to compel the SEC to respond to its petition. At the same time, the SEC sued Coinbase for listing and trading crypto tokens which, according to the SEC, are securities. Needless to say, the fight between Coinbase and the SEC is far from over.
- **Federal judge declines to reconsider ruling on motion to dismiss in Compound lawsuit.** Recall that Judge William Orrick of the Northern District of California denied a motion to dismiss in Q3 2023, rejecting the investment firm defendants’ claims that they were merely “collateral” participants in the transaction. The class-action plaintiffs alleged that multiple co-founders and investment firms solicited investments in a crypto asset called COMP, the native token of DeFi lender Compound Finance. We noted in our [Q3 2023 issue](#) that each defendant sought leave to file motions to reconsider the ruling, arguing that plaintiffs had “expressly abandoned any claim that so-called Partner Defendants were directly liable for solicitation.”

- On October 31, 2023, Judge Orrick denied the defendants' request to file motions for reconsideration. No opinion was published.
- On October 25, 2023, each defendant also brought counterclaims against the plaintiffs, alleging that each plaintiff, under their legal theory of ownership of COMP tokens, is also a general partner in the Compound DAO and is consequently jointly and severally liable. Defendants claim this necessarily permits their request for equitable contribution, indemnification, or reimbursement from plaintiffs for damages. The defendants also claim that the plaintiffs violated their duty of care and loyalty in permitting their partners to sell or offer for sale allegedly unregistered securities.

Legislation

- **California Governor Newsom signed [Assembly Bill 39](#), the Digital Financial Assets Law ("DFAL"), on October 13, 2023.** The bill establishes a comprehensive regulatory scheme, requiring individuals and firms to obtain a license from the Department of Financial Protection and Innovation before engaging in "digital financial asset business activity" with California residents. Some companies that are approved to conduct a virtual currency business under New York law may be eligible for a conditional license.
 - For example, the bill defines "digital financial asset" as a "digital representation of value that is used as a medium of exchange, unit of account, or store of value, and that is not legal tender," subject to some exemptions. The bill also exempts activity from certain actors, most notably commercial banks with deposits that are insured by the Federal Deposit Insurance Corporation.
 - The bill takes effect July 1, 2025. In his [signing statement](#), Governor Newsom emphasized that the bill gives the Department of Financial Protection and Innovation time to exercise its rulemaking authority and an 18-month implementation period to provide clarity to the industry. Violations of the licensing requirement can result in a penalty of up to \$100,000 for each day of the violation, assessed by the Department.
 - The California law mirrors New York's BitLicense law, which was met with [strong criticism](#) in 2015, resulting in many crypto exchange platforms [leaving New York altogether](#). But industry response in California appears to be more optimistic. Kraken, a crypto exchange that left New York nine years ago, [stated](#) its commitment to working with the California Department of Financial Protection and Innovation. Other blockchain and software companies, like Consensys, expressed apprehension towards the bill's vague language, emphasizing the need for clarity and recognition of industry risks.
- **Governor Newsom also signed Senate Bill 401, relating to [Digital Financial Asset Transaction Kiosks](#).** This companion bill to the Digital Financial Assets Law is only valid if Assembly Bill 39 is also enacted. It seeks to regulate digital financial asset transaction kiosks, prohibiting operators from accepting or dispensing more than \$1,000 in a day from or to a customer from a kiosk. The bill also requires operators to provide certain written disclosures to customers and provide the Department of Financial Protection and Innovation with a list of the locations of the kiosks that the operators own.
 - While this bill received considerably less media attention, it was still met with criticism. Primarily, the \$1,000 transaction cap strikes many in the kiosk industry as "[arbitrary](#)." Others noted that the bill [might undermine federal reporting requirements](#), which mandate suspicious activity reporting [when \\$2,000 is withdrawn](#).
- **New Jersey moves to designate certain virtual currencies as securities.** A bill was introduced in the New Jersey Assembly to consider all virtual currencies issued and sold to institutional investors as securities under state law. The bill would amend the New Jersey Uniform Securities Law, which currently does not address virtual or digital currency or cryptocurrency. If passed, the law would only affect transactions governed by New Jersey law.
- **U.S. Senators Thom Tillis (R-NC) and John Hickenlooper (D-CO)** introduced bipartisan legislation that would establish consumer safeguards for holding customer assets in the digital asset space. The Proving Reserves of Others Funds ("PROOF") Act would prohibit unethical co-mingling of funds and require crypto exchanges to have third-party auditing firms verify their proof of reserves on a monthly basis, which is considered best-practice. The proposed legislation is another measure arising directly out of the FTX collapse—FTX's lack of reserves resulted in large part from its co-mingling of customer funds with its institutional and proprietary funds and the diversion of portions of its customer deposits to its subsidiary, Alameda Research.
- **Congress debates crypto's role in illicit financing of terrorist operations.** In November, Congressional House members sought to understand illicit crypto flows, in light of recent [media](#) and [government reports](#) that Hamas had funded its operations using cryptocurrency. But [lack of reliable statistics](#) stymied efforts to find consensus between Republicans and Democrats. Experts pointed out in a hearing that data on illicit transactions provided by blockchain analytics firms may be underinclusive since many illicit transactions take place "off-chain." Moreover, experts pointed out that recent statistics, relied upon in media reports, do not have a consistent method of measuring which transactions are illicit.

- Representatives Patrick McHenry (chair of the House Financial Services Committee) and French Hill (chair of the Digital Asset subcommittee) issued [a bipartisan letter](#), signed by 53 members of Congress, asking President Biden and Treasury Secretary Yellen to provide more information on Hamas' crypto account, transfers, and fundraising.

Looking Ahead

To stay ahead of the curve, we look for insights from Ropes & Gray litigation and enforcement lawyers working in the field. This quarter's featured insight:

On January 17, 2024, U.S. District Judge Katherine Polk Failla of the Southern District heard oral arguments in *SEC v. Coinbase, Inc. and Coinbase Global, Inc.*, which focused in part on when and whether digital assets are securities under *Howey*. The court also heard somewhat novel constitutional arguments regarding whether the SEC overstepped its authority by categorizing digital assets as investment contracts under its purview. Since Judge Failla did not decide the matter from the bench, industry participants eagerly await her decision—which could take weeks, or even months, given her stated intention to review the transcript of the five-hour exchange and consider additional questions before reaching a decision. We will follow this decision and its implications in future editions of the Crypto Quarterly.