Crypto Quarterly

Digital Assets, Blockchain and Related Technologies Update

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ROPES & GRAY

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

The U.S. Securities and Exchange Commission ("SEC") and Commodity Futures Trading Commission ("CFTC") have continued to be active in the digital asset space, bringing numerous enforcement actions for violations of both anti-fraud and registration rules. In addition, the SEC garnered quite a bit of attention with its rule-making activity. Both agencies also requested additional financial and personnel resources in their congressional budget requests for the 2025 fiscal year to, among other things, ramp up their oversight and reach over the digital asset market.

1. In Watershed Moment for the Digital Asset Industry, the SEC Approves Spot Bitcoin Exchange-Traded Products

- On January 10, 2024, the SEC approved 11 spot bitcoin exchange-traded products ("ETPs") for listing and trading after rejecting such applications for nearly a decade. The agency's change of course comes on the heels of a successful court challenge by Grayscale Investments, LLC ("Grayscale"), which took the SEC to court after the agency denied its application in June 2022 to convert its bitcoin fund, Bitcoin Trust (known as "GBTC"), into an exchange-traded fund ("ETF"), citing Grayscale's failure to address concerns around market manipulation. Soon after, Grayscale filed a petition challenging the decision with the U.S. Court of Appeals for the District of Columbia Circuit, arguing that the SEC's position was inconsistent with its previous decisions to greenlight other bitcoin-based ETFs, such as those based on futures markets. In August 2023, the court ruled that the SEC had failed to adequately explain its decision and that Grayscale had advanced "substantial evidence" that its product was similar to previously-approved bitcoin futures ETFs. *Grayscale Investments, LLC v. SEC*, No. 22-1142, 82 F.4th 1239 (D.C. Cir. 2023). That ruling forced the SEC to reconsider Grayscale's application, along with others.
- In his statement announcing the approval, SEC Chair Gary Gensler acknowledged the *Grayscale* ruling and characterized the approval of the 11 spot bitcoin ETPs as "the most sustainable path forward." Chair Gensler indicated that the approval is accompanied by investor protection measures, including certain required disclosures and listing on registered national securities exchanges that have rules designed to prevent fraud and manipulation. Chair Gensler further noted that the SEC would investigate any fraud or manipulation and emphasized that existing rules and standards of conduct will apply to the purchase and sale of the approved ETPs.
- Nevertheless, the statement emphatically disclaimed that the SEC would soften its approach to cryptocurrency and other digital assets. The approval was expressly limited to ETPs holding bitcoin, and the announcement made clear that the approval "in no way signal[s] the Commission's willingness to approve listing standards for crypto asset securities[,]" nor does it "signal anything about

the Commission's views as to the status of other crypto assets under the federal securities laws or about the current state of non-compliance of certain crypto asset market participants with the federal securities laws."

- The SEC's approval of bitcoin ETPs should not be construed as a sign that the SEC is open to approving ETPs holding other digital assets in the near term, particularly given Chair Gensler's frequent distinction between most digital assets that he believes are "securities," and Bitcoin, which he has characterized as a "commodity." (Only Ethereum potentially falls into that bucket together with Bitcoin and, notably, the SEC approved spot Ethereum ETFs in May after the close of the quarter; that decision will be discussed in the next edition of the Crypto Quarterly.) Indeed, Chair Gensler has likened the agency's oversight over the new spot bitcoin ETPs to its existing oversight over other spot non-security commodity ETPs, such as precious metals. Chair Gensler reiterated his caution against bitcoin, noting that, in contrast to other non-security commodities, "bitcoin is primarily a speculative, volatile asset that [is] also used for illicit activity," and emphasized that the SEC has not "approve[d] or endorse[d] bitcoin."

2. New SEC Definition of "Dealer" Will Apply to Digital Asset Industry

- On February 6, 2024, the SEC announced new rules defining a "dealer" under the Securities Exchange Act of 1934, expanding the definition to include those who control more than $50 million and who regularly buy and sell securities near the best available price. The rules take full effect in April 2025. The new definition of a "dealer" covers market participants who have significant liquidity-providing roles, pulling more financial operations into the SEC's jurisdiction, including those dealing in digital assets. As the SEC announced: "The dealer framework is a functional analysis based on the securities trading activities undertaken by a person, not the type of security being traded." According to the statement, any market participant who "trades in a manner consistent with de facto market making" must register with the SEC as a dealer. While the text of the rule acknowledged objections from the digital asset industry, including those in DeFi, the SEC made clear that the industry would not be exempt from the new rule: "[W]hether there is a dealer involved in any particular transaction or structure . . . is a facts and circumstances analysis. . . . There is nothing about the technology used, including distributed ledger technology-based protocols using smart contracts, that would preclude crypto asset securities activities from falling within the scope of dealer activity."

3. When is a Digital Asset a Security? The SEC Chalks Up Another Favorable Ruling

- The issue of what digital assets are securities subject to SEC oversight has been heavily debated in federal courts over the last year. On March 27, 2024, the SEC scored a win in its ongoing lawsuit against Coinbase, *SEC v. Coinbase, Inc. et al.*, 23-cv-04738 when it defeated Coinbase's motion to dismiss the lawsuit. Specifically, in denying Coinbase's judgment on the pleadings, Judge Katherine Polk Failla of the U.S. District Court for the Southern District of New York held that the allegations in the complaint plausibly support the SEC's assertion that Coinbase operated as an unregistered intermediary of securities because at least some digital asset trades on the Coinbase platform plausibly met the definition of an investment contract under the U.S. Supreme Court's longstanding "*Howey* test" articulated in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The court's finding allows the SEC to proceed to fact and expert discovery on its claims that Coinbase improperly operated as a securities exchange, broker and clearing agency. Judge Failla dismissed the SEC's claim that Coinbase acted as an unregistered broker on the ground that Coinbase's involvement in its Wallet application was minimal.
  - The decision embraced an "ecosystem" approach to applying the *Howey* test to digital asset transactions, mirroring the analysis recently applied by another federal district judge in the Southern District of New York, Judge Jed Rakoff, to rule on summary judgment that, as a matter of law, four of Terraform's digital assets were securities. *SEC v. Terraform Labs Pte. LTD*, No. 23-cv-1346 (S.D.N.Y. Dec. 28, 2023).
  - The "ecosystem" approach focuses on communications and other circumstances "surrounding" digital asset transactions to determine the existence of an investment contract, defined by the Supreme Court in *Howey* as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promotor or a third party." 328 U.S. at 298. Judge Failla held that "the challenged transactions fall comfortably within the framework that courts have used to identify securities for nearly eighty years." Specifically, she held that the SEC had sufficiently alleged that Coinbase's staking program involves transactions in securities because the tokens are transferred, pooled and staked by Coinbase with an expectation by investors that Coinbase's management and technical efforts will lead to profits for investors. The opinion notably states: "When a customer purchases a token on Coinbase's platform, she is not just purchasing a token, which in and of itself is valueless; rather, she is buying into the token's digital ecosystem, the growth of which is necessarily tied to value of the token."
- In parallel, the SEC has been sparring with lawyers for Binance on the same question in the U.S. District Court for the District of Columbia, *SEC v. Binance Holdings Ltd.*, No. 1:23-cv-01599 (D.D.C., filed June 5, 2023). While oral argument on Binance's motion to dismiss the SEC's claims was held in January 2024, just days after the *Coinbase* oral argument before Judge Failla, a decision has yet to be reached as of the writing of this issue.

4. The SEC's So-Called "Regulation by Enforcement" Strategy Faces Ongoing Pushback

- As with its court loss in *Grayscale*, the SEC continues to face pressure from the industry, courts, states and certain SEC Commissioners to justify its active enforcement in the digital asset arena and to set clear rules for the industry.

  - **Coinbase continues its push for rulemaking.** Last quarter, we reported that the SEC rejected Coinbase's petition requesting that the SEC set out clear industry rules. In a supporting statement, SEC Chair Gensler simply said the petition was denied because digital assets "already fall under existing rules and regulations." Coinbase promptly appealed the decision in the U.S. Court of Appeals for the Third Circuit, arguing that the SEC acted arbitrarily in denying the petition and asking the court to overturn the SEC's denial and order the securities regulator to begin the rulemaking process. On March 11, 2024, Coinbase filed their opening brief in the appeal.

  - **State AGs challenge the SEC's expansive claim to jurisdiction in the *Kraken* litigation.** In an amicus brief filed in the SEC's case against Kraken's parent companies, eight state Attorneys General pushed back against enforcement actions being taken by the agency in cases involving digital assets. The SEC filed the suit in November of last year, alleging that Kraken operates as an unregistered exchange, commingles customer funds, and lists certain digital assets that the SEC claims are securities. The states are challenging the SEC's so-called "regulation by enforcement" approach, alleging that the agency has not been given the power to regulate digital assets as securities and that it has exceeded "its delegated powers" in attempting to regulate "non-securities." The states claim that the SEC's approach could preempt and thereby undermine state consumer protection laws which, the states argue, are "better tailored to the specific risks of non-securities products." The states allege that the SEC is trying to "ignore" limitations on its authority and "apply [the term] 'investment contract' to assets that do not meet the *Howey* definition."

    – Several defendants, including Binance and Coinbase in the cases detailed above, have likewise challenged the SEC's jurisdiction by arguing that, instead of bringing enforcement actions, the SEC should either have waited for Congress to enact laws regulating the burgeoning industry or engaged in formal rulemaking to guide digital asset issuers and exchanges. Defendants have also more broadly asserted that the SEC's flurry of enforcement actions runs afoul of the U.S. Supreme Court's major questions doctrine, which prohibits federal agencies from expanding their power without express Congressional authorization in matters of great economic and political significance. Judge Failla rejected this argument in her *Coinbase* opinion, holding that the SEC is well within its bounds to pursue enforcement actions and regulate digital assets.

  - **SEC Commissioners' Dissent Criticizes the SEC's Lack of Clear Industry Guideposts.** On March 5, 2024 ShapeShift AG, a former cryptocurrency exchange, agreed to pay a modest fine to the SEC to resolve allegations that it had failed to register as a securities dealer. In a dissenting opinion, self-identified Republican Commissioners Peirce and Uyeda took issue with the barebones language of the SEC's order, which merely stated, after describing ShapeShift's business, that "[t]he crypto assets offered by ShapeShift included those that were offered and sold as investment contracts and, therefore, securities, under *SEC v. W.J. Howey Co.*" The dissenting commissioners noted that the order failed to identify which digital assets the SEC considered securities: "In sum, ShapeShift is in trouble because the Commission, nearly ten years after ShapeShift's platform started trading and more than three years after it changed its business model, now contends that some unidentified number of the 79 crypto-assets it traded between 2014 and 2021 were investment contracts without explaining why."

5. The SEC and CFTC break up more fraudulent schemes

- **The SEC busts HyperFund masterminds.** On January 29, 2024, the SEC charged the founder, Xue Lee (aka Sam Lee), and top promoter, Brenda Chunga (aka Bitcoin Beautee), of HyperFund with violating anti-fraud and registration provisions of the federal securities laws. Between 2020 and 2022, Lee and Chunga allegedly promoted HyperFund "membership" packages to attract investors with the promise of ongoing passive "rewards" to double or triple their initial investment. To convince investors, Lee and Chunga claimed that these returns were made possible by substantial revenue from large scale cryptocurrency mining operations. In reality, according to the complaint, the $1.89 billion pyramid scheme's only source of revenue was from investors, and the scheme collapsed in 2022. The U.S. Attorney's Office for the District of Maryland announced parallel criminal charges against Lee for operating an unlicensed money transmitting business, and conspiracy to do the same, and against Chunga for conspiracy to commit securities fraud and wire fraud. Chunga settled with both the SEC and the U.S. Department of Justice ("DOJ"). An additional co-conspirator and alleged promoter, Rodney Burton (aka Bitcoin Rodney), was charged in the criminal action with one count of operating an unlicensed money transmitting business and one count of conspiracy to do the same.

- **The SEC disciplines a teacher.** On February 2, 2024, the SEC settled charges against Brian Sewell and his company, Rockwell Capital Management, for violating

the anti-fraud provisions of the federal securities laws. Between 2018 and 2019, Sewell allegedly defrauded students enrolled in his online crypto trading course, the American Bitcoin Academy, when he encouraged them to invest in the Rockwell Fund, a hedge fund he claimed he would launch. According to the SEC, Sewell claimed that the fund would make use of advanced technologies and trading strategies involving digital assets to generate returns for investors. Instead, Sewell purportedly never launched the fund, and held the $1.2 million investment received from students in bitcoin until it was eventually stolen as a result of a hack.

- **The SEC takes another swing at CryptoFX LLC.** On March 14, 2024, the SEC charged 17 individuals for their roles in a purported $300 million Ponzi scheme that targeted Latino investors, alleging violations of the antifraud, securities-registration, and broker-registration provisions of the federal securities laws. From May 2020 to October 2022, the defendants, located across the U.S., attracted investors to CryptoFX by promising that its crypto asset and foreign exchange trading would generate returns between 15% and 100%. According to the SEC, the defendants raised $300 million from more than 40,000 investors that the defendants used to pay back other investors and divert to themselves. In September 2022, the SEC filed an emergency action in the U.S. District Court for the Southern District of Texas seeking a temporary restraining order, orders freezing assets, and other emergency relief, largely halting the alleged scheme. Two individuals the SEC identified as the alleged scheme's main leaders were charged in 2022, and the additional 17 defendants were identified in the course of the SEC's subsequent investigation.

- **The CFTC charges Debiex.** On January 19, 2024, the CFTC filed an enforcement action against Debiex for fraudulently misappropriating $2.3 million from five customers in violation of the anti-fraud provisions of the Commodities Exchange Act. The CFTC alleged that Debiex officers used romance scam tactics to connect with customers on social media and cause them to open and fund Debiex trading accounts, assuring them that their funds would be invested in digital asset commodities. Unbeknownst to the customers, according to the CFTC, Debiex's website merely mimicked a legitimate trading platform, and no trades were ever executed for the customers. The complaint named an individual, Zhāng Chéng Yáng, as a defendant, for his role as a "money mule," i.e., a participant who receives and moves criminal proceeds at someone else's direction. Zhāng allegedly used his digital asset wallet to misappropriate customer funds for Debiex.

6. The SEC and CFTC continue to enforce registration provisions

- **The SEC Seeks $2 Billion from Ripple.** In *SEC v. Ripple Labs, Inc.*, 20-cv-10832 (S.D.N.Y., filed Dec. 22, 2020), in which the SEC alleged that Ripple's sale of its token, XRP, violated the federal securities laws, the SEC has asked the court for a final judgment ordering Ripple to pay a staggering $2 billion in disgorgement, pre-judgment interest, and civil penalties. On July 13, 2023, Judge Analisa Torres issued the groundbreaking summary judgment ruling that Ripple's sale of XRP to retail investors on secondary trading platforms and through algorithms did not constitute transactions in securities under the *Howey* test, while its direct sales to institutional investors did constitute transactions in securities. The ruling contradicts the more recent rulings in the *Terraform* and *Coinbase* litigations that secondary trading platform transactions of various digital assets plausibly qualify as investment contracts under the *Howey* test. Ripple CEO Brad Garlinghouse, in a post on X (formerly Twitter), called the SEC's request unprecedented. Lawyers for Ripple responded in an opposition filing that "[t]he SEC's remedial requests are more evidence of the administrative overreach that has beset this case."

- **The SEC settles with TradeStation.** On February 7, 2024, the SEC announced charges against TradeStation Crypto, Inc. for failing to register the offer and sale of an interest-bearing digital asset lending product that it offered between 2020 and 2022. In addition to a $1.5 million penalty, TradeStation announced that it would cease its operations in the U.S. by the end of February 2024. The settlement is the latest of a series of similar enforcement actions applying the securities laws to interest-bearing digital asset lending products, such as actions against BlockFi, Celsius, and Nexo Capital. TradeStation will also pay $1.5 million as part of a multi-state settlement in connection with the same conduct.

- **The CFTC sanctions Empires Consulting.** On March 15, 2024, the U.S. District Court for the Southern District of Florida entered a consent order in the CFTC's action against Empires Consulting Corp. and several of its executives, imposing a permanent injunction, restitution, and a civil monetary penalty against the defendants. The court ruled that Empires Consulting defrauded participants of approximately $100 million through unlawfully operated commodity pools. The CFTC had alleged that Empires Consulting used its website and social media to attract individuals to trade commodity futures, options, and digital assets using its commodity pool, which operated, unregistered under the name EmpiresX. According to the court's order, Empires Consulting, through its officers and employees, knowingly made false claims to prospective pool participants regarding its registration status, the use of participant funds, the size of the pools, and participant returns. The court also held that Empires Consulting commingled and misappropriated participant funds.

  - In 2023, the SEC obtained final orders from the U.S. District Court for the Southern District of Florida resolving charges against Empires Consulting and the individual defendants for violations of the registration

and anti-fraud provisions of the securities laws. The DOJ filed a parallel criminal action against the three individual defendants in 2022, charging each with one count of conspiracy to commit wire fraud and one count of conspiracy to commit securities fraud. The CFTC's litigation against the individual defendants remains ongoing, and the DOJ's action resulted in one guilty plea and remains ongoing with respect to the remaining individual defendants.

- **The CFTC charges KuCoin, asserting that ether is a commodity.** On March 26, 2024, the CFTC filed an enforcement action against Mek Global Limited, PhoenixFin PTE Ltd., Flashdot Limited, and Peken Global Limited, which collectively operate a centralized digital asset exchange under the name KuCoin. The CFTC alleges multiple violations of the Commodity Exchange Act ("CEA") and CFTC regulations, namely that KuCoin operated a facility for leveraged, margined, or financed retail commodity and commodities futures transactions without registering with the CFTC, operated as a registered futures commission merchant, and failed to implement customer identification programs and Know Your Customer ("KYC") and Anti-Money Laundering ("AML") procedures. Notably, the CFTC's complaint characterized ether as a commodity, along with several other digital assets, publicly laying claim to enforcement authority over ether in its ongoing tug-of-war with the SEC.
  - The DOJ filed a parallel criminal enforcement action against the exchange and two of its founders for violating the Bank Secrecy Act ("BSA"), operating an unlicensed money transmitter business, and conspiracy in furtherance of the same. According to the DOJ, KuCoin was required to register with the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") and comply with applicable BSA requirements, such as maintaining an adequate AML program and KYC processes. The DOJ alleged that KuCoin knowingly failed to establish, implement, and maintain effective AML and KYC programs and processes, resulting in widespread use of the exchange as a vehicle for illicit activity. Furthermore, the indictment alleged that KuCoin attempted to conceal its U.S. customers to skirt BSA requirements. By resisting these KYC and AML policies and processes, KuCoin was purportedly able to transmit more than $4 billion of "suspicious and criminal funds" and received $5 billion from operating "in the shadows of the financial markets."
  - The CFTC and DOJ enforcement actions come on the heels of KuCoin's $22 million settlement with New York Attorney General Letitia James, reported in the previous issue of the quarterly, to resolve allegations that it operated as an unregistered exchange. Contrary to the CFTC's position, that enforcement action characterized ether as a security.

7. The DOJ Continues to Target Fraud and Money Laundering Schemes

- **Bankman-Fried Sentenced:** On March 28, Judge Lewis A. Kaplan in the U.S. District Court for the Southern District of New York sentenced Samuel Bankman-Fried ("SBF") to 25 years imprisonment and 3 years of supervised release, and ordered that he forfeit $11 billion in connection with his conviction for multiple fraudulent schemes involving the FTX exchange and trading firm Alameda Research. SBF was found guilty of wire fraud, conspiracy to commit wire fraud, conspiracy to commit securities fraud, conspiracy to commit commodities fraud, and money laundering following a one-month trial.

- **Historic Binance Settlement Approved.** On February 23, 2024, Judge Richard Jones of the U.S. District Court for the Western District of Washington approved a record-breaking settlement, announced in November 2023, between Binance and several federal regulators. Under the terms of the settlement, the exchange will pay $4.3 billion and appoint two independent compliance monitors.

- **CEO Charged in Multi-Million Dollar International Fraud Scheme.** On January 19, 2024, Horst Jicha, a German national, was charged with securities fraud and conspiracies to commit securities fraud, wire fraud, and money laundering for his role as CEO of USI Tech, an online investment platform that purported to make digital assets investments accessible to retail investors. The platform was allegedly a marketing scheme that relied on investors recruiting other investors to make investments. According to the indictment, in 2017, Jicha aggressively marketed USI Tech to U.S. retailers on social media and through in-person presentations, falsely promising high returns and assuring investors of the legality of the platform's investment offerings. In early 2018, after USI Tech faced regulatory scrutiny, it ceased all U.S. operations overnight, leaving investors with no ability to access their money and resulting in millions of dollars in losses.

- **Meta-1 Coin:** On March 19, 2024, the DOJ announced an indictment in the U.S. District Court for the Northern District of Illinois charging Robert Dunlap with four counts of mail fraud in connection with his alleged role in a $10 million initial coin offering scam. Dunlap developed a digital asset called "Meta-1 Coin" and promoted it through the "Meta-1 Coin Trust." Dunlap allegedly made misrepresentations to actual and potential investors regarding the currency's backing, including that it was backed by $44 million in gold and priceless art, the value of which he claimed was certified by an accounting firm. According to the indictment, Dunlap created false documentation to conceal that Meta-1 Coin Trust did not possess the gold or art, and created fake trades on the exchange to mimic an active market.

- **Digitex:** On February 13, 2024, the DOJ brought charges in the U.S. District Court for the Southern District of Florida against Adam Colin Todd, the CEO of Digitex Futures Exchange, for willful violations of the BSA by failing to implement an adequate AML program at Digitex Futures. According to the indictment, Todd operated Digitex Futures as an unregistered futures commission and failed to comply with BSA requirements, and publicly stated that he refused to do so.

- **BTC-e:** On February 1, 2024, the DOJ unsealed an indictment charging a Belarusian and Cypriot national, Aliaksandr Klimenka, with money laundering conspiracy and operation of an unlicensed money services business. According to the indictment, Klimenka controlled a digital currency exchange, with others, that became a cybercrime and money laundering hub. BTC-e allegedly allowed users to maintain a high degree of anonymity, resulting in a largely criminal customer base, and facilitated large volumes of criminal transactions and received criminal proceeds from illicit activity. Although BTC-e purportedly conducted significant business and maintained its servers in the United States, it did not register as a money services business or implement an anti-money laundering program as required under the BSA.

- **Bitcoin Fog Operator Convicted.** On March 12, 2024, a federal jury in Washington, D.C. convicted a dual Russian-Swedish national for his role in operating the longest-running bitcoin money laundering service on the darknet. Roman Sterlingov was involved in operating Bitcoin Fog, a mixer that was allegedly notorious for money laundering, from 2011 through 2021. Bitcoin Fog purportedly moved over 1.2 million bitcoin, which was valued at approximately $400 million at the time of the transactions. The jury convicted Sterlingov of money laundering conspiracy and sting money laundering, and of operating an unlicensed money transmitting business and money transmission without a license.

- **Tornado Cash developer challenges criminal indictment.** Roman Storm moved to dismiss a criminal indictment alleging he conspired to commit money laundering and violate U.S. sanctions. The DOJ alleged that Tornado Cash, which has been sanctioned multiple times by the U.S. Treasury Department, facilitated the laundering of over $1 billion. Storm's motion challenged the DOJ's theory of Storm's ability to influence its operation, arguing that Storm merely developed code for the platform, a "free and open source" platform, and did not have the ability to control Tornado Cash or prevent its use by illicit actors. Storm's motion further argued that he could not have conspired to launder funds or operate a money transmitter if there was no Tornado Cash enterprise for him to have carried out such operations with.

- **DOJ Joins Forces with IRS to Bring First-of-its-Kind Digital Asset Tax Charge.** A Texas man was indicted in connection with filing false tax returns and structuring cash deposits to skirt currency transaction reporting requirements in order to avoid reporting the sale of $4 million of bitcoin in which he had substantial gains. The defendant allegedly filed a false tax return inflating the price he had paid for the bitcoin to underreport his capital gains, and failed to report more the $650,000 in sales of bitcoin. Unlike previous tax cases involving digital assets, the allegations arose from legitimate transactions in digital assets that defendant failed to accurately report, and did not relate to other criminal activities, such as money laundering or theft.

PRIVATE LITIGATION

8. Digital Asset-Related Class Actions

- **Federal court greenlights FTX customers' suit against Silvergate Bank.** On March 20, 2024, Judge Ruth Bermudez Montenegro of the U.S. District Court for the Southern District of California denied Defendant Silvergate Bank's motion to dismiss in *Bhatia v. Silvergate Bank*, No. 3:23-cv-01406. In 2023, a class of FTX customers brought claims against Silvergate Capital Corporation, Silvergate Bank, and former Silvergate CEO Alan J. Lane (together, "Silvergate") for unjust enrichment, violations of California's Unfair Competition Law, negligence, aiding and abetting fraud, aiding and abetting conversion, and aiding and abetting breach of fiduciary duty. In her order allowing the suit to go forward, Judge Montenegro said "[t]he present case is a novel one involving the burgeoning crypto industry," in assessing factors for a duty of care to third parties in connection with the negligence claim. The court held that the plaintiffs had adequately alleged that Silvergate knew of and benefitted from FTX's fraud and unjustly enriched itself at the expense of FTX users through the income it earned from transaction fees and interest on money deposited into FTX-related accounts. The court ruled that Silvergate owed a duty of care to FTX customers because its Silvergate Exchange Network, created to facilitate moving funds to digital asset exchanges, was designed to and did attract and benefit FTX customers. The judge found that it was "foreseeable that allowing FTX customer funds to be deposited into non-FTX accounts would lead to fraud and harm the owners of those funds."

- **Second Circuit reverses lower court dismissal of Binance putative class action.** On March 8, a panel on the U.S. Court of Appeals for the Second Circuit unanimously reversed the May 2022 ruling dismissing *Lee v. Binance*, No. 22-00972 (2d Cir. May 02, 2022). Investors in Binance sued in 2020 in the U.S. District

Court for the Southern District of New York, claiming that Binance offered and sold billions of dollars of unregistered digital tokens to investors in violation of federal and state securities laws. The district court dismissed the case in 2022, holding that the lawsuit was untimely and that U.S. securities laws could not be applied to Binance because it denies having a place of business in any jurisdiction due to its decentralized operations. In reversing the ruling, the Second Circuit panel held that the suit was timely filed under the securities laws and that the U.S. securities laws applied to the transactions at issue. The court applied the "irrevocable liability test," first articulated in *Absolute Activist Value Master Fund v. Ficeto*, 677 F.3d 60 (2d Cir. 2012), which analyzes whether a securities transaction is domestic based on when and where the parties become bound to an agreement to buy or sell securities. The panel concluded that the underlying transactions may be domestic, because the investors claimed their orders were matched with offers from counterparties on servers in the U.S. Accordingly, the panel ruled, the U.S. securities laws applied to the transactions at issue despite Binance's decentralized operations and claimed lack of primary jurisdiction. The lawsuit will return to the district court for further litigation.

- **National Basketball Association sued for Voyager promotion.** Investors in Voyager Digital Holdings ("Voyager") filed a class action against the National Basketball Association and its law firm McCarter & English in the U.S. District Court for the Southern District of Florida. *Karnas et al. v. McCarter & English, LLP et al.*, 24-cv-20480 (S.D. Fla., filed Feb 06, 2024). Plaintiffs allege that the NBA was "grossly negligent" in approving a marketing deal between Voyager and the Dallas Mavericks promoting the exchange that resulted in more than $4 billion in investor losses. The complaint claims that McCarter & English played a role in the alleged misrepresentations surrounding Voyager by preparing a legal opinion at Voyager's request concerning Voyager's token ("VGX") and its Voyager Earn Program Accounts to assure investors that Voyager's offerings were not unregistered securities. Voyager filed for bankruptcy in July 2022 as a result of its exposure to defunct hedge fund Three Arrows Capital. The same group of investors sued Mark Cuban (the former owner of the Dallas Mavericks) for purportedly promoting and misrepresenting the exchange in 2022.

- **Apple wins motion to dismiss proposed antitrust class action over digital asset payment apps.** In November 2023, four consumers filed a proposed antitrust class action under Section 1 of the Sherman Act in U.S. District Court for the Northern District of California against Apple. *Pierre et al. v. Apple Inc.*, No. 3:23-cv-05981 (N.D. Cal., filed Nov 17, 2023). The consumers alleged that Apple's terms of service with Apple Cash competitors Google LLC, Block Inc. and PayPal stifle competition by preventing those apps from integrating digital asset features in their products, namely Venmo, Cash App and Google Pay. On March 26, 2024, U.S. District Judge Vince Chhabria dismissed the suit, holding that the allegations were "speculative" and that the plaintiffs had not made clear how the terms of service were anticompetitive.

- **Ninth Circuit reinstates some claims against Apple in theft class action.** On March 27, 2024, the Ninth Circuit partially reinstated a putative class action accusing Apple of misrepresenting the safety of its App Store after users' cryptocurrency was stolen in a phishing scam disguised as a digital wallet app. *Hadona Diep, et al. v. Apple, Inc.*, No. 22-16514 (9th Cir., filed Oct 03, 2022). The appellate panel affirmed the dismissal of fraud and wiretapping claims, holding that they were barred by Section 230 of the Communications Decency Act, which shields website operators from liability for content posted by third parties on their platforms. The panel ruled that this immunity did not extend to plaintiffs' three consumer protection claims, which it reinstated, on the ground that Apple's representations about its App Store and the process for reviewing the applications it makes available renders it the primary, rather than third-party, information provider. Plaintiffs argued that users relied on Apple's representations when downloading a "phishing" app posing as a digital wallet called Toast Plus, which ultimately stole their cryptocurrency. The panel also rejected the lower court's finding that the state consumer protection law claims were foreclosed by the "Limitation of Liability" provision contained in Apple Media Services' terms and conditions, ruling that Apple could not disclaim liability for its statements.

- **YouTuber Logan Paul offers to buy back NFTs he promoted while facing fraud class action.** Logan Paul offered refunds for NFTs purchased through CryptoZoo amid a pending class action accusing him of fraud. Logan Paul launched and promoted CryptoZoo, a Pokémon-inspired NFT game, in 2021, but it was never released. Consumers that invested in the game's tokens to participate in the game sued Paul for fraud in 2023. In January 2024, Paul announced in an X (formerly Twitter) post that he would commit $2.3 million to buy back the NFTs purchased through CryptoZoo in exchange for release of all claims against him and related persons or entities. *Holland v. CryptoZoo*, No. 1:23-cv-110 (W.D. Tex., filed Feb. 2, 2023).

  - Logan Paul is one of many celebrities and prominent organizations to be sued for their endorsements and promotions of defunct digital asset trading platforms. As discussed in the previous edition of the Crypto Quarterly, Kim Kardashian and Major League Baseball are among other prominent figures and entities that faced lawsuits.

9. Evolving Role of Digital Asset Technology in Litigation

- **Alaska Federal District Court authorizes service of process on defendants using blockchain technology.** In a lawsuit against defendants in foreign countries, a plaintiff obtained court permission to serve the summons and complaint on overseas defendants via NFT. The plaintiff's complaint alleges several business torts, including misappropriation of trade secrets and unfair competition. The court held that service via NFT containing a link to the legal documents and dropped into defendants' digital wallets satisfied U.S. constitutional requirements and did not violate any laws in the foreign countries in which the defendants resided. The Court recognized the increasing role that digital, and sometimes unconventional, communication methods play in legal proceedings. In this case, the defendants were already active on and familiar with blockchain technology. *CipherBlade, LLC v. CipherBlade, LLC*, No. 3:23-cv-00238 (D. Alaska, filed Oct. 19, 2023).

10. Litigating Crypto's Environmental Impacts

- **Crypto mine faces nuisance complaint and investigation.** Two dozen residents in Faulkner County, Arkansas are suing a nearby crypto mine owned by Newrays One LLC for excessive noise, power usage, and other public grievances. The complaint alleges that the crypto mine emits constant sounds that disturb the county's residents. A noise ordinance was issued to limit the mine's data centers to a specific maximum decibel level, and the mine's owner, Newrays, is also under investigation by the Arkansas Attorney General and Secretary of Agriculture.

- **Proposed New York crypto mine met with environmental challenge.** On March 7, 2024, a New York Supreme Court Third Appellate Department panel reinstated a lawsuit filed by the Clean Air Coalition of Western New York, the Sierra Club, and Earthjustice against Digihost International Inc. to prevent the development of a crypto mine at the site of a former natural gas power plant near Buffalo, New York. The plaintiffs argue that the development, which was approved by the New York Public Service Commission, could increase the plant's greenhouse gas emissions by more than 3,000% and would violate and hinder New York's ambitious 2019 climate law, the Climate Leadership and Community Protection Act, which includes a zero-emissions electricity target for 2040. The Public Service Commission had acknowledged the potential environmental legal challenges when it approved the development, but stated that those issues were "beyond the scope" of its review and approval of the development. The panel held that plaintiffs had standing to pursue their claims due to their physical proximity to the proposed mine. Associate Justice Eddie McShan wrote: "While we need not express a definitive position as to whether the unwinding of the transaction is feasible at this juncture, other relief is available, such as the environmental mitigation expressly contemplated in the [Climate Leadership and Community Protection Act]."

- **Bitcoin miner and industry association reach settlement following federal government emergency energy information collection effort.** On February 22, 2024, the Texas Blockchain Council ("TBC")—a nonprofit industry association— and Riot Platforms, Inc.—a TBC member and Bitcoin mining company—filed a lawsuit against the U.S. Department of Energy ("DOE"), the U.S. Energy Information Administration ("EIA") and the U.S. Office of Management and Budget ("OMB") in United States District Court for the Western District of Texas. On January 24, 2024, EIA sought an emergency collection of information under Form EIA-862, Cryptocurrency Mining Facilities Survey pursuant to the emergency collection procedures of the Paperwork Reduction Act ("PRA"), which OMB approved. The survey sought to require commercial cryptocurrency miners to provide details related to their energy use to enable EIA to "analyze and write about the energy implications of cryptocurrency mining activities in the United States." Plaintiffs alleged that the emergency collection and its approval was invasive, the urgency of which was "contrived" and violated the PRA, the Administrative Procedure Act, and various statutory and regulatory requirements governing the emergency collection of information.
  - Plaintiffs were granted a TRO on February 23, 2024. Three days later, OMB withdrew the emergency collection and EIA announced that it had "decided that it will not proceed through the emergency collection procedures . . . with respect to an information collection covering data of the type described in Form EIA-862," and would, instead, "proceed through the PRA's notice-and-comment procedures . . . to determine whether to request that OMB approve any collection of information covering such data." The parties reached a settlement that required EIA to destroy any information it had already received in the response to the survey and compelled the DOE to utilize a standard "public notice and comment" process if they choose to gather similar data in the future.

- **Pennsylvania nonprofit sues over alleged pollution stemming from mining cryptocurrency.** On March 25, 2024, nonprofit Save Carbon County sued Pennsylvania Governor Josh Shapiro, state agencies, crypto miners and power companies in the Philadelphia Court of Common Pleas over alleged pollution resulting from mining cryptocurrency. The complaint claims that the state "violated its fiduciary duties to residents of Carbon County and to citizens throughout Pennsylvania" under the state constitution's Environmental Rights Amendment. The complaint also

alleges that Stronghold's operations create a public and private nuisance by impeding the use of land, clean water, fresh air, and individual properties.

- Save Carbon County claims that crypto-mining company Stronghold Digital Mining, along with its fellow-defendant subsidiaries, generates and consumes its own electricity by burning waste coal and old tires, "polluting the environment and harming neighbors." The complaint alleges that Stronghold acquired the Panther Creek power plant in 2021 and has operated it at full capacity by burning waste as a fuel source.

- Save Carbon County is seeking damages from Stronghold and also asks that Stronghold's tax credits and its permits to operate and to burn tires be revoked. Save Carbon County also wants the company to conduct quarterly emissions testing and environmental hazard assessments, and for the state to develop relevant regulations.

LEGISLATION

State Legislation Gains Momentum. While federal legislation continues to stall, this quarter saw key developments in several states grappling with how to best regulate digital assets on behalf of their residents.

- **Virginia**'s State Senate passed Senate Bill 439, which takes a similar approach to legislation under consideration in other states, such as New York. The bill seeks to establish a Blockchain and Cryptocurrency Commission within the legislative branch of the state department to study and make recommendations regarding blockchain technology, crypto, and other digital assets.

- **Wyoming**, a state that has been at the forefront of blockchain and digital asset legislation, enacted Senate File 50 to create a new legal structure tailored specifically for the decentralized operations of decentralized autonomous organizations ("DAOs"). The legislation seeks to establish a new category within the existing Wyoming Unincorporated Nonprofit Association statute designed to accommodate the unique operational structure of DAOs.

- **Louisiana** introduced a virtual currency business activity licensing program. in SB 28, which was referred to the state's Committee on Commerce, Consumer Protection, and International Affairs for review.

- **Illinois** is also exploring the possibility of a licensing regime for digital asset business activity, introducing SB 3666 in the State Senate. Illinois also advanced the Uniform Money Transmission Act (SB 3412), which aims to implement nationwide standards for supervising money transmission, including digital asset businesses operating with Money Transmitter Licenses in Illinois.

- **Utah** enacted HB 118, a privacy and security measure for digital asset holders, which establishes protections against the unlawful compulsion to produce private keys.

- The **New York** State Comptroller's office recently released a report assessing deficiencies in the state's BitLicense application process and the Department of Financial Services' supervision of virtual currency business activities within the state. The Comptroller's office expressed concern regarding the "risk that licenses could be granted to applicants whose financial stability has not been thoroughly verified or that, once licensed, businesses may not maintain financial or cybersecurity standards." The report recommends that DFS take additional measures to affirm that its licensees and charter holders are in compliance with DSF regulations and exhibit financial stability. The report also makes several recommendations the Comptroller's office believes will enhance the application and supervisory processes.

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:

Q2 and Q3 of 2024 are shaping up to be significant quarters for the SEC. Although there is reason for optimism in light of the SEC's recent approval of spot Bitcoin ETPs (and subsequently, in the following quarter, spot Ethereum ETPs), the primary catalysts for change in the regulatory environment are perhaps more likely to come from forces outside the SEC itself (such as through legislative initiatives) rather than a change of perspective within the SEC itself. Indeed, in a late March 2024 speech addressing the "public good" that accompanies mandatory securities disclosures, Gensler reiterated his view that registration and disclosure requirements should apply to the digital asset industry, suggesting that the SEC is likely to continue with its current approach to enforcement.