



THE LANDSCAPE OF GOVERNMENT ENFORCEMENT, private litigation, and federal and state regulation of DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES is constantly changing. 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.

ENFORCEMENT ACTIONS

1. Federal Agencies Build Up Enforcement Apparatus

While there was a marginal slowdown in new cryptocurrency enforcement actions during the second quarter of 2022—including just four new actions from the U.S. Securities and Exchange Commission (“SEC”) and two from the U.S. Commodity Futures Trading Commission (“CFTC”)—each of the key regulators in this space has recently taken concrete actions to enhance its enforcement apparatus.

- On June 6, 2022, in response to a directive from President Biden, the U.S. Department of Justice (“DOJ”) published a [report](#) on how to strengthen international law enforcement cooperation for detecting, investigating and prosecuting criminal activity related to digital assets. The report was spearheaded by the agency’s nascent National Cryptocurrency Enforcement Team (“NCET”), which is led by former Southern District of New York prosecutor Eun Young Choi. Incidentally, Ms. Choi’s appointment in February 2022 coincided with the Federal Bureau of Investigation’s (“FBI”) announcement the same month

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creating a Virtual Asset Exploitation Unit and an International Virtual Currency Initiative.

- In May 2022, the SEC [relaunched](#) the agency’s “Cyber Unit” as the “Crypto Assets and Cyber Unit” and simultaneously announced the creation of 20 additional positions at both its Washington headquarters and across several regional offices, nearly doubling the unit’s size. The continued build-up at the SEC is particularly notable for an agency that has long asserted authority over a wide swath of digital asset transactions (which it considers to be securities under the catchall category of “investment contracts” defined by the Supreme Court in a seminal 1946 case called *SEC v. W.J. Howey Co.*).
- Also in May 2022, CFTC Chairman Rostin Behnam announced that the agency would add resources to allow it to more aggressively pursue cryptocurrency-

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related fraud and manipulation cases. These remarks, made during an industry conference in New York City, come on the heels of proposed federal legislation (discussed below) that would vest significant enforcement authority within the CFTC. The comments also follow Chair Behnam's [statement](#) in his October 2021 confirmation hearing that the CFTC should be given primary responsibility for crypto enforcement, as well as his [request](#) in February 2022 to the Senate Agriculture Committee that the CFTC receive clear authority to regulate certain cryptocurrencies, including Bitcoin.

The efforts of these and other regulators to assert greater authority over digital asset transactions is [not a new phenomenon](#) and sometimes lead to overlapping enforcement efforts aimed at a single target, whether intentionally through inter-agency cooperation or otherwise. For instance, a wide-ranging enforcement sweep against six individuals in four different actions that was announced on the last day of the quarter (discussed in more detail below) involved support from at least seven distinct government agencies working in close collaboration with each other and with industry partners.

2. Insider Trading Comes to Crypto with a Twist

- In June 2022, DOJ [announced](#) charges against a former employee of non-fungible token (“NFT”) marketplace OpenSea in the [first-ever digital asset insider trading prosecution](#). The former employee, Nathaniel Chastain, allegedly selected the NFTs that would be featured on OpenSea's homepage—a decision that typically increased their value—after secretly purchasing dozens of those same NFTs before they were featured. Notably, the decision to charge Chastain with money laundering and wire fraud underscores DOJ's efforts to pursue insider trading regardless of whether an asset qualifies as a “security.”¹
- For its part, insider trading actions remain on the SEC's radar as well, as the agency sent [confidential inquiry letters](#) to several cryptocurrency exchanges in June 2022 asking how these platforms protect users from insider trading facilitated through their networks. Industry ana-

lysts have tied the flurry of inquiry letters to May's \$40 billion decline of Terraform Lab's stablecoin (UST) and governance token (LUNA), discussed further below, while the SEC reportedly also pursues an investigation into whether Terraform itself violated investor protection rules.

3. Other Notable Enforcement Actions

Federal law enforcement agencies continued to pursue actions based on other developing areas as well, including against cryptocurrency exchanges.

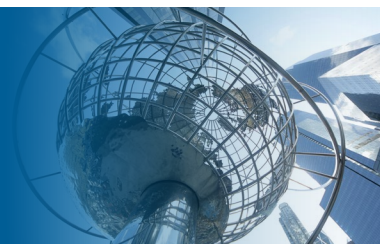
- On June 30, 2022, DOJ [announced](#) criminal charges against six defendants in four separate cases for their alleged involvement in cryptocurrency-related frauds, including the largest known NFT scheme charged to date, a crypto investment fund that allegedly swindled millions from investors by misrepresenting its trading strategy and successes, an alleged Ponzi scheme involving the sale of unregistered crypto securities, and a purportedly fraudulent initial coin offering. The charges include various forms of wire, securities and commodities fraud, as well as conspiracy to commit those frauds and at least one count of money laundering. Beyond the breadth of the charges, the enforcement actions are also notable for the breadth of the investigatory team, which included DOJ Main Justice, various U.S. Attorney's Offices, the FBI, the Department of Homeland Security's Homeland Security Investigations, the Internal Revenue Service's Criminal Investigation Division, the Office of Inspector General for the Board of Governors of the Federal Reserve System, the Bureau of Consumer Financial Protection, and certain “industry partners” operating in a public-private partnership with those government agencies.

Ropes & Gray will be issuing a client alert providing further analysis of these indictments and their potential implications for industry participants.

- In an [opinion](#) unsealed in May 2022, Magistrate Judge Zia M. Faruqi (D.D.C.) ruled that the DOJ had probable

¹ For more information on a variety of business models using NFTs and the related legal considerations for companies considering entering these markets, you can read [this article](#) by Ropes & Gray IP litigation partner Matt Rizzolo and IP transactions partner Regina Sam Pentti.

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cause to accuse an unnamed defendant of transmitting more than \$10 million in Bitcoin to a “comprehensively sanctioned” country in one of the first criminal cases involving cryptocurrency brought under U.S. sanctions laws. Although the platform allegedly used by the defendant advertised that its services were designed to evade U.S. sanctions, investigators were able to determine the defendant’s identity through subpoenas to virtual currency exchanges, email search warrants, banking information and shell company registration information. The government has alleged that the defendant conspired to violate the International Emergency Economic Powers Act and to defraud the United States, explicitly adopting interpretive guidance from the U.S. Office of Foreign Assets Control.

PRIVATE LITIGATION

1. Significant Uptick in Securities Class-Action Litigation

Class-action litigation has continued to increase over the past quarter, and although many such cases continue to follow SEC actions or comments regarding the propriety of certain conduct, it is beginning to establish itself as a bellwether for future disputes in this space.

- Several cases arising under the [Securities Act of 1933](#) and/or the [Securities Exchange Act of 1934](#) have claimed that crypto creators have participated in the unregistered offering or sale of securities or committed fraud in the purchase or sale of securities. For example, the May 2022 [complaint](#) in *Pasquinelli et al. v. Humbl, LLC* hits both of those notes, arguing that Humbl, the blockchain-based merchant payment and financial services company, made false and misleading statements concerning growth prospects while keeping its stock price artificially high and, at the same time, selling unregistered securities (BLOCK ETX digital assets) to investors. The latter allegations are particularly notable, as BLOCK ETXs were marketed to “simplify digital asset investing” for customers seeking exposure to cryptocurrency investments, but are alleged to have in fact been highly speculative and risky.

- At the same time, courts and litigants continue to struggle to determine when, if ever, cryptocurrency losses entitle coin-holders to protections under securities laws. Most notably, a June 2022 [ruling](#) by a federal judge in the District of Connecticut in *Audet v. Fraser* overturned a jury verdict finding that a digital currency known as PayCoin did not qualify as a security under the *Howey* test. In rejecting the conclusion of one of the first juries to consider this question, the court focused on the second and third prongs of the *Howey* test and concluded that any finding by the jury that the virtual coin was not a “common enterprise” or that expected profits would not be derived from the efforts of others was against the weight of the evidence. On the former, the court rejected the defendant’s argument that horizontal commonality under *Howey* strictly required pooling of money or cryptocurrency, and instead found that contributing other items of value—in this case “mining rewards” and “Hashpoints” (essentially in-house credit that users could trade for PayCoin)—was sufficient to establish the common enterprise. On the latter, the court rejected defendant’s arguments that the digital currency PayCoin was not “centralized” because it operated on open-source software that anyone could mine, and that it was not an “investment” because it was intended to be used primarily as a medium of exchange.

This Ropes & Gray [client alert](#) provides further analysis of the *Audet v. Fraser* decision.

- Similar issues are likely to surface in the several cases that have targeted crypto exchanges and creators for losses related to the collapse of Terraform’s so-called [stablecoin, UST, and the platform’s natively produced token, LUNA](#). While Terraform faces its own legal challenges in the wake of “depegging” its flagship coin from the U.S. dollar (including by the SEC as noted above), the related class-action suit against crypto trading platform Binance will be closely watched. Binance was previously able to [secure dismissal](#) of an unrelated 2020 class action on the grounds that any trades occurred on ex-U.S. exchanges and, thus, were not subject to U.S. securities laws. Whether the [new suit](#)—against a 2019-founded subsidiary, Binance U.S., that is incorporated in Dela-

² For more on stablecoins, how they are intended to operate and their importance to the overall digital assets markets, [listen to a podcast](#) (with transcript) from Ropes & Gray asset management attorneys Melissa Bender and Charlie Humphreville.

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ware and based in California—can avoid a similar fate will have far-reaching implications for the industry moving forward.²

–Underscoring the importance of the 2020 Binance ruling prohibiting extraterritorial application of U.S. securities laws to crypto exchanges and digital assets, the CEO of Ripple, Brad Garlinghouse, announced in late June that if his company loses its ongoing lawsuit against the SEC—which Garlinghouse projected at Coindesk’s recent Consensus Conference might ultimately cost more than \$100 million to defend—he will move the company out of the United States.

2. Private Actions Go Beyond Securities Claims

Beyond securities-based claims, a number of private actions related to digital assets have been filed premised on contract law, fiduciary duty theories and traditional fraud principles.

- For example, the May 2022 [complaint](#) against a decentralized autonomous organization (“DAO”) known as bZx is notable for both its cause of action and the named defendants. First, the complaint raises a negligence claim based on allegations that one of the DAO’s developers fell victim to a phishing hack, exposing the crypto wallets of everyone doing business with the exchange. More critically, the complaint—which names as defendants the DAO, its co-founders *and all of its members*—alleges that because the DAO lacks any legal formation or recognition, it constitutes a general partnership, and thus its members are jointly and severally responsible for the plaintiffs’ losses.
- Additionally, several class-action cases have targeted memecoin creators and promoters for alleged “pump and dump” or “pyramid” schemes. For example, purchasers of Dogecoin have sued self-proclaimed “Dogefather” Elon Musk (along with Tesla and SpaceX) for alleged civil RICO violations, common law fraud, negligence and unjust enrichment. The [complaint](#) seeks \$258 billion in damages—more than three times Dogecoin’s all-time

high market cap—and alleges that Musk “used his pedestal as World’s Richest man to operate and manipulate the Dogecoin Pyramid Scheme for profit, exposure, and amusement” by promoting the token and accepting it at his companies. Similarly targeting those who promote coins through large public platforms, purchasers of the “LGB” or “Lets Go Brandon” token are seeking damages based on a [claim](#) that its creators and promoters committed unfair trade practices and violated federal and state securities laws through their high-profile “pump and dump” promotion of the coin, including through a proposed partnership with NASCAR, which is also named as a defendant.

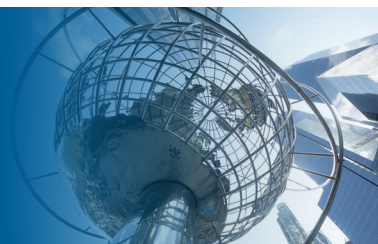
FEDERAL LEGISLATION AND REGULATION

1. Lummis-Gillibrand Bill Reveals Sweeping Proposal

In early June 2022, Senators Cynthia Lummis (R-WY) and Kirsten Gillibrand (D-NY) introduced in the U.S. Senate the bipartisan [Responsible Financial Innovation Act](#) to regulate digital assets. The proposed legislation is wide-reaching compared to previous legislative efforts that addressed narrower areas of the cryptocurrency regulatory landscape, and its sponsors have indicated that the bill is intended to jumpstart lawmaking efforts in this burgeoning area. The bill attempts to tackle major uncertainties regarding digital assets, create regulatory clarity for agencies charged with supervising digital asset markets and integrate digital assets into existing tax and banking laws. In particular, the proposed legislation sets federal rules for stablecoins and deciphers the line between crypto securities and commodities, notably favoring the CFTC in classifying Bitcoin, Ether and dozens of other tokens that currently have significant market share as commodities. In addition, the bill grants the CFTC authority over the spot markets in crypto commodities.

- Agency Response: CFTC Chair Behnam stated that the bill “does a very good job,” noting, in particular, its delineation of a commodity and security. The agency has recently advocated to have greater oversight of crypto.

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SEC Chair Gary Gensler, in contrast, indicated in a recent public appearance that the proposed legislation could inadvertently undermine other market protections and, specifically, disclosure requirements for public fundraising. He noted that his agency's objective is to protect its role in overseeing public fundraising efforts and expressed doubt that all tokens listed on crypto exchanges are commodities, rather than securities.

- **Industry Response:** Lobbying groups have largely praised the proposal as a milestone for crypto policy and a comprehensive start to achieving regulatory clarity. However, some industry insiders have echoed SEC Chair Gensler's concerns relating to disclosure rules in this space.
- **Sponsor Response:** Senators Lummis and Gillibrand promoted their new bill while speaking on a panel at CoinDesk's Consensus Conference in Austin, Texas (attended and co-sponsored by Ropes & Gray), including making clear their expectation that portions of the bill relating to stablecoins will pass later this year. The legislators also suggested they worked with the SEC and CFTC in crafting this legislation, although a CFTC spokesman confirmed only that the senators received technical assistance and the SEC declined to comment.

For more on the Lummis-Gillibrand bill, please see this [client alert](#) from Ropes & Gray.

2. Treasury Regulations Target Unhosted Wallets

- Speaking in June at the same Consensus Conference at which Sens. Lummis and Gillibrand described their new legislation, U.S. Deputy Treasury Secretary Wally Adeyemo [made remarks](#) regarding his regulatory priorities for the coming months, specifically identifying [unhosted wallets](#) as an area for future regulation. Adeyemo indicated that his agency is working with financial institutions to prevent abuse from the heightened anonymity these accounts provide, noting that “[f]undamentally, financial institutions need to know who they are transacting and doing business with to make sure they are not making payments to criminals, sanctioned entities, or others.”

STATE SPOTLIGHT

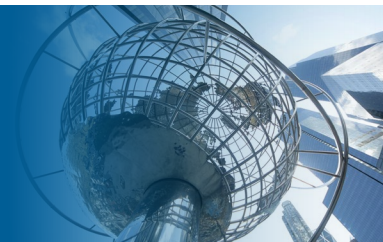
1. Several States Continue to Develop Impactful Legislation and Regulation

- In May 2022, the [California Department of Financial Protection and Innovation](#) (“DFPI”) [published](#) an “Invitation for Comments on Crypto Asset-Related Financial Products and Services Under the California Consumer Financial Protection Law” pursuant to California Governor Gavin Newsom’s May 4, 2022 Executive Order N-9-22, which aims to develop a comprehensive, coordinated state regulatory framework for digital asset technologies. The DFPI will be responsible for developing and publishing consumer protection principles, promulgating consumer education materials, and undertaking monitoring and enforcement, and has been tasked with coordinating with federal agencies and state financial regulators as well as soliciting comments from the public and industry stakeholders.

[Read more](#) in Ropes & Gray’s client alert on this topic.

- In June 2022, [Wyoming](#) legislators revived efforts to establish a state stablecoin and to be the first government entity in the United States to issue a virtual currency, after the legislation was unexpectedly vetoed by the governor despite bipartisan support by wide margins. Wyoming native and Wall Street veteran Caitlin Long, a champion for this law and other digital asset reforms, has dubbed Wyoming the “Delaware of digital asset law,” a moniker that is only likely to be bolstered by Senator Lummis’s involvement in developments at the federal level.
- Lastly, in [New York](#), Bill A7389C—intended to establish a moratorium on cryptocurrency mining operations that use a proof-of-work authentication method to validate blockchain transactions—recently [passed](#) through the state Senate and Assembly. If signed by Gov. Kathy Hochul, the bill would create a two-year ban on the issuance of new cryptocurrency mining permits and would hamper efforts by those attempting to repurpose fossil fuel plants into cryptocurrency mining facilities.

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2. State Consumer Protection Laws Bolster Federal Causes of Action

While—at least for the moment—cases alleging state-level causes of action have largely been married with related federal claims, state-specific consumer protection laws are increasingly being used to afford plaintiffs a second (or third) bite at the apple in litigation against crypto creators and operators. For example, such cases have been brought under California’s Unfair Competition and False Advertising laws, Illinois’ Consumer Protection and Deceptive Trade Practices Act, and the Florida Deceptive and Unfair Trade Practices Act. *See, e.g., Pearl et al. v. Coinbase*, No. 3:22-cv-03561 (N.D. Cal.); *Merewhader v. Safemoon LLC*, No. 2:22-cv-1108 (C.D. Cal.); *DeFord v. Koutoulas et al.*, No. 22-cv-0652 (M.D. Fla.).

LOOKING AHEAD

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

Non-profit organizations and educational institutions are increasingly accepting crypto-donations. As the regulatory landscape continues to shift, these institutions should stay abreast of regulatory guidance related to such donations and should consider bolstering their internal controls by drafting compliance policies tailored to accepting gifts in the form of digital assets.

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For more information on any of these issues, or if you would like to speak with someone with particular experience in any of these areas, please reach out to any of the attorneys below or your usual Ropes & Gray contact.³

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