

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.

ENFORCEMENT ACTIONS

The Securities and Exchange Commission (“SEC”) has ramped up its enforcement activity since early summer, announcing seven major enforcement actions and reportedly undertaking investigations into every U.S. crypto exchange, including both Coinbase and Binance, the largest crypto exchanges in the United States and the world, respectively. Meanwhile, the SEC, the Commodity Futures Trading Commission (“CFTC”), and other federal agencies continue to compete for regulatory authority over digital assets and related transactions.

1. SEC Ramps Up Enforcement Actions

The SEC's steady drumbeat of enforcement actions—in conjunction with frequent public statements from Chairman Gary Gensler—continue to demonstrate the agency's commitment to reining in what it views as the “Wild West” of the financial services sector. The SEC has also continued to make clear its [position](#) that the overwhelming majority of digital assets are securities and thus subject to federal securities laws and regulations.

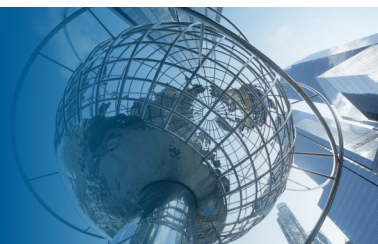
■ **Hydrogen Technology Corporation.** Coming in just under the wire this quarter, the SEC [charged](#) Hydrogen and an associated marketing firm, Moonwalkers, on September

TABLE OF CONTENTS

■ ENFORCEMENT ACTIONS	1
■ SEC RAMPS UP ENFORCEMENT ACTIONS	1
■ SEC AND CFTC: CONTINUED STRUGGLE FOR REGULATORY PRIMACY	3
■ DOJ: A FOCUSING OF RESOURCES	4
■ OTHER NOTABLE ENFORCEMENT ACTIONS....	4
■ PRIVATE LITIGATION.....	5
■ SECURITIES LITIGATION	5
■ SECURITY MEASURES & DATA BREACHES	6
■ BREACHED CONTRACTS & BROKEN PROMISES.....	6
■ FRAUD & MISREPRESENTATION.....	7
■ BANKRUPTCY	7
■ LEGISLATIVE AND REGULATORY UPDATE.....	9
■ LOOKING AHEAD.....	9

28, 2022, for allegedly making unregistered offers and sales of a crypto asset called “Hydro” and for manipulating the trading volume and price of that asset. According to the complaint, Hydro was distributed to the public in a number of ways, including through bounty programs, which paid the token to individuals in exchange for promoting it; employee compensation; and direct sales on crypto asset trading platforms. Notably, in contrast to many of the SEC's previous actions alleging registration violations, Hydro was not distributed through an initial coin offering (“ICO”). The complaint

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



alleges that Moonwalkers used bots to create artificial market activity for Hydro, which it then sold at inflated prices on Hydrogen’s behalf, ultimately resulting in more than \$2 million of profits. The SEC has taken this opportunity to [highlight](#) its view that companies “cannot avoid the federal securities laws by structuring the unregistered offers and sales of their securities as bounties, compensation, or other such methods.”

- **Sparkster.** On September 19, 2022, the SEC announced a \$35 million [settlement](#) with Sparkster and its CEO for violating Section 5 of the Securities Act of 1933 (the “Securities Act”) by holding an unregistered offer and sale of the “SPRK” token. Sparkster and its CEO—who himself was actively involved in promoting the token on social media in the run-up to and during the offering—promised investors that the tokens would increase in value, that management would continue to improve Sparkster, and that the tokens would be available on a crypto trading platform. The SEC’s cease-and-desist [order](#), issued in conjunction with the settlement announcement, found that the SPRK token was a security under the *Howey* test. In addition to the settlement, the SEC announced a civil [action](#) against crypto influencer Ian Balina for failing to disclose compensation he received from Sparkster for publicly promoting the SPRK token and failing to file a registration statement with the SEC.
- **Chicago Crypto Capital.** On September 14, 2022, the SEC filed a civil [complaint](#) alleging that, from approximately August 2018 through November 2019, Chicago Crypto Capital LLC and certain individual defendants acted as unregistered broker-dealers and conducted an unregistered offering of digital assets known as “BXY” tokens, raising at least \$1.5 million from around 100 individuals, many of whom had no experience investing in crypto assets. In addition to alleging violations of Section 5 of the Securities Act, the SEC contends that each of the defendants made materially false and misleading statements in the offer, purchase, and sale of the BXY tokens.
- **Dragonchain.** On August 16, 2022, the SEC [alleged](#) that blockchain start-up Dragonchain, Inc. violated Section 5 of the Securities Act by failing to register more than

\$16 million in crypto assets sold to more than 5,000 investors over five years. The SEC highlighted several facts it claims indicate the digital assets are securities—namely, Dragonchain’s discounted “presale” in August 2017 to members of a crypto investment club; public statements regarding the assets’ growth prospects made during its ICO in October and November 2017; various attempts to market the coin’s investment value, pricing, and “listing” on trading platforms; and the fact that the company had offered and sold \$2.5 million more of its coin after a state regulator found that the coin was a security.

- **Bloom Protocol.** On August 9, 2022, the SEC reached a [settlement](#) with Bloom Protocol, LLC concerning alleged Securities Act violations for conducting an unregistered ICO. Bloom must pay a \$300,000 penalty, compensate any harmed investors, and register its tokens with the SEC; otherwise, it will be subject to a \$30.9 million penalty (equal to what it raised through the ICO). From the SEC’s vantage point, it made no difference that, at the time of the offering, Bloom required purchasers to agree that they were buying the token for “utility” and not as an investment. Instead, the SEC alleged that a reasonable expectation of future profit was apparent from Bloom’s decision to conduct an ICO, and emphasized Bloom’s promotional efforts and statements by some early buyers (which the SEC claimed suggested buyers *did* intend to turn a profit on the investment).
- **Okhotnikov, et al. (Forsage).** On August 1, 2022, the SEC [announced](#) a lawsuit against 11 individuals for their roles in creating and promoting Forsage.io, a website that allowed millions of retail investors to enter into transactions via smart contracts. The SEC alleges that Forsage amounts to a Ponzi scheme, whereby investors earned profits by recruiting others into the scheme, and assets from new investors were used to pay profits to earlier investors. Forsage raised over \$300 million from retail investors, and the SEC’s lawsuit comes on the heels of findings from two other government entities—[one](#) from the Security and Exchange Commission of the Philippines in September 2020 and the [other](#) from the Montana Commissioner of Securities and Insurance in

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



March 2021—that Forsage was operating a fraudulent pyramid scheme.

- **Wahi, et al.** Filed on July 21, 2022, this [complaint](#) appears to be first insider trading action based on a cryptocurrency. The SEC’s complaint alleges that nine of Coinbase’s digital tokens are securities, and that the three *Wahi* Defendants—one of whom worked at Coinbase during the period at issue—violated SEC Rule 10b-5 by trading on insider information before a listing.

— As we discuss in the next section, the *Wahi* case has opened up new fault lines in the ongoing back-and-forth between regulators. Responding to the SEC’s decision to bring the action, CFTC Commissioner Caroline D. Pham issued a [statement](#) implying that the SEC was overstepping its bounds and engaging in “regulation by enforcement.” The Department of Justice (“DOJ”), for its part, announced that it is also bringing criminal charges against the *Wahi* defendants based on the underlying conduct—pursuant to a federal wire fraud theory—and [recently reached](#) a settlement with one defendant in that case.

- **Ripple.** Meanwhile, in a closely watched case that is perceived by many as a critical test of the SEC’s reach over digital asset activity, Ripple secured a major discovery victory in its long-running litigation with the SEC. On September 29, 2022, a judge in the U.S. District Court for the Southern District of New York [ordered](#) the agency to turn over emails and drafts concerning a June 14, 2018, speech on cryptocurrencies given by William Hinman, the SEC’s former director of the Division of Corporation Finance. The speech—in which Hinman said that applying the SEC’s regulatory regime for securities to the “offer and resale of Bitcoin would seem to add little value” and that “current offers and sales of Ether are not securities transactions”—and associated comments from the SEC could be a major boon to Ripple’s efforts to rebuff the SEC’s claim that it was reckless in believing that its digital token, XRP, would not be considered a security by regulators. Ripple, for its part, has continued to maintain that the SEC’s lawsuit came after a long stretch of regulatory uncertainty surrounding cryptocurrencies—meaning that

its executives could not reasonably have had “fair notice” regarding the status of XRP—and that, in any event, the SEC has failed to demonstrate that XRP is a security under the *Howey* test. The internal SEC emails could bolster those theories. Both parties have filed motions for summary judgment on the underlying merits.

2. SEC and CFTC: Continued Struggle for Regulatory Primacy

This quarter, both the SEC and CFTC have bolstered their digital assets teams and have issued several public statements staking out their respective regulatory roles.

- The SEC appears to be fulfilling the promise Chairman Gensler made in a recent *Wall Street Journal* [op-ed](#) that the SEC will continue to serve as the main cop on the crypto beat. This quarter, the SEC [doubled](#) the number of line attorneys in its newly renamed Crypto Assets and Cyber Unit. In parallel, Chairman Gensler continued to maintain that the crypto industry [does not need to be regulated any differently](#) than any other financial services firms subject to securities laws. Moreover, despite recently [acknowledging](#) that Bitcoin should be regulated as a commodity consistent with the CFTC’s position, Chairman Gensler recently made [comments](#) suggesting that Ether may properly fall under the SEC’s purview given Ethereum’s newly upgraded proof-of-stake blockchain (which allows coinholders to earn financial rewards by locking up their assets in order to validate transactions).

[Read more](#) on the Ethereum merge and questions raised by the transition to a proof-of-stake consensus mechanism in Ropes & Gray’s client alert on this topic.

- The CFTC, for its part, has looked to bolster its capabilities related to digital assets by creating and augmenting offices and staff positions. The agency [announced](#) that it will create the Office of Technology Innovation, formerly LabCFTC, and increase staffing in the Chairman’s Office. In its announcement, the CFTC noted that, given the “unprecedented rise in retail futures, options and digital asset trading,” its Office of Customer Education and Outreach will align with the Office of Public Af-

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



fairs and undertake staffing changes as well. Relatedly, in a July 25, 2022, [speech](#) at the Brookings Institution, CFTC Chairman Behnam discussed the trajectory of cryptocurrency, the regulatory landscape, and the CFTC's role in that landscape, underscoring the need to develop "cooperative arrangements between regulators." Perhaps not to be outdone by SEC Chairman Gensler, Chairman Behnam in his remarks also signaled that the CFTC will continue to increase its regulatory activity in crypto markets: "Make no mistake: we will use all levers at our disposal, and all relevant authorities to continue rooting out fraud and manipulation," he said. During this quarter, the CFTC announced five enforcement actions based on alleged violations of the Commodity Exchange Act's registration requirements and anti-fraud provisions.

3. DOJ: A Focusing of Resources

- On September 16, 2022, the DOJ announced its Report on Digital Assets and launched a nationwide network of prosecutors selected to focus on digital asset crimes. The [report](#) expounds on digital asset crimes and the prevention techniques, regulatory actions, and legislative measures available to thwart crypto criminals. The DOJ also [launched](#) its Digital Asset Coordinator ("DAC") Network, which brings together over 150 federal prosecutors from various U.S. Attorney's Offices to serve as the Department's central team to receive training, expertise, and guidance about digital asset crimes. The Director of the National Cryptocurrency Enforcement Team, Eun Young Choi, will oversee the DAC Network.
- In addition, the DOJ has continued to bring charges against individuals and entities for various crypto fraud schemes and scams—notably, for wire fraud related to digital assets. In September 2022, Asa Saint Clair was [sentenced](#) to 42 months in prison for a digital asset investment scheme in *United States v. Saint Clair*, No. 1:19-cr-790 (S.D.N.Y.) after deceiving investors into thinking his organization was affiliated with the United Nations and promising a guaranteed financial return.

4. Other Notable Enforcement Actions

This quarter also saw major actions from the Internal Revenue Service ("IRS"), the U.S. Treasury, and the Federal Trade Commission ("FTC"), as well as new actions from state enforcement agencies, in the digital assets space.

- **The IRS.** The IRS is off to a successful start in its campaign to determine whether customers of crypto prime dealer SFOX Inc. ("SFOX") have been failing to report and pay taxes on income derived through their crypto assets. This quarter, the IRS went two-for-two on motions filed in federal courts in [New York](#) and [Los Angeles](#). The motions both requested permission to serve so-called "John Doe" summonses on SFOX and M.Y. Safra Bank, an entity that partnered with SFOX in 2019 to offer its customers cash deposit accounts backed by the FDIC. The IRS is seeking account and transaction records for customers with cryptocurrency transactions over \$20,000 in any year from 2016 to 2021. "Transactions in cryptocurrency have grown substantially in recent years, and the IRS is concerned that taxpayers are not properly reporting these transactions on their tax returns," a lawyer for the government said. The IRS previously served similar summons on [Kraken](#), the San Francisco-based crypto exchange, and [Circle](#), the Boston-based issuer of USD Coin.
- **U.S. Treasury.** On August 8, 2022, the U.S. Treasury Department [imposed](#) sanctions on a major cryptocurrency platform, Tornado Cash, accusing it of laundering billions of dollars in virtual currency, including \$455 million allegedly stolen by North Korean hackers. The Treasury Department said Tornado Cash had failed to impose effective controls to stop its users from laundering funds for malicious cyber actors. The Treasury Department alleged that the platform was used to launder more than \$7 billion in cryptocurrency since 2019, but private sector analysts believe that figure conflated illicit funds and legitimate transactions. The Treasury has maintained a heightened focus in the last year towards the virtual currency ecosystem and its potential ability to hide proceeds from illicit cyber activity and

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



other crimes: “Criminals are increasingly using these technologies to obfuscate the identities of those sending and receiving proceeds of illicit activities,” a senior Biden administration official said.

— Relatedly, Coinbase is funding a federal lawsuit challenging the Treasury Department sanctions. The [complaint](#) accuses the Treasury of overstepping its authority by imposing sanctions on “decentralized, open-source software,” rather than specific criminal users, thereby preventing lawful users from accessing their funds. Coinbase’s CEO, Brian Armstrong, likened the sanctions to “permanently shutting down a highway because robbers used it to flee a crime scene.”

■ **FTC.** The FTC is investigating the operators of the BitMart cryptocurrency exchange over a December 2021 hack that led to consumer losses of between \$150 million and \$200 million, which marks the agency’s first known probe into crypto markets. The FTC’s probe is multi-faceted, involving “BitMart’s representations concerning its advertised exchange services; allegations that consumers have been denied access to their accounts; and concerns about the security of customer accounts.” The probe intends to determine whether BitMart engaged in “unfair [or] deceptive ... acts or practices ... relating to the marketing of goods and services,” as well as “deceptive or unfair acts or practices related to consumer privacy and/or data security.” The FTC had sent civil subpoenas in May to the BitMart operators, seeking details on what the companies told consumers about the security of their crypto assets, how they have handled customer complaints, and whether the BitMart operators were complying with another federal law that requires financial institutions to safeguard sensitive customer data. BitMart moved to quash the subpoenas, and the FTC [denied](#) that petition on August 9, 2022. The FTC issued a similar order on July 18 to Spread Technologies LLC, another entity associated with BitMart’s operations.

■ **New York Attorney General.** On September 26, 2022, New York’s Attorney General Letitia James capped off a

busy month for her office by [announcing](#) charges against cryptocurrency lending platform Nexo Inc. for falsely claiming it was registered under state law while promoting and selling an interest-bearing virtual currency account called Earn Interest Product. According to the [complaint](#), Nexo had agreed to stop providing such services in the state in response to an October 2021 cease-and-desist letter, but nonetheless continued to handle more than 5,000 New York-based accounts into July of this year. While it is the first state to bring charges, New York is not alone in its concerns over Nexo’s registration status, as regulators in at least seven other states have taken official action related to the company, with California [issuing](#) a cease-and-desist letter claiming that the Earn Interest Product is a security under its state law.

— State enforcement actions are only one of the challenges facing Nexo, as the company continues to face private litigation as part of the fallout from the SEC’s December 2020 lawsuit against Ripple and the subsequent collapse in value of its digital asset, XRP. In a California civil suit, Nexo has been [accused](#) of improperly suspending XRP as a payment option and liquidating its customers’ collateral, breaching its agreement with users and resulting in over \$5 million in damages.

PRIVATE LITIGATION

1. Securities Litigation

As private securities actions continue to proliferate in the crypto space, individual litigants have taken note of some of the SEC’s more aggressive theories of liability and have leveraged those arguments in support of their own causes. In some instances, that has led to litigants using positions taken by the SEC to *defend* against liability in private litigation, as with the “LGBcoin” case we covered last quarter. There, the defendants [argued](#) that the plaintiffs lacked evidence of a common enterprise under *Howey*, pointing to the absence of a “white paper” or similar prospectus, which the SEC has previously [highlighted](#) as a source for such allegations. Conversely, the SEC has recently argued that because Ethereum nodes are “[clustered more densely](#)”

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



in the U.S. than elsewhere, Ethereum transactions are subject to U.S. securities laws. This argument, if successful, is almost certain to be adopted by private litigants seeking a forum in U.S. federal court.

In the meantime, additional private securities actions from this quarter include:

- In *Mangano v. BlockFi et al.*, No. 2:22-cv-01112 (D.N.J., filed March 1, 2022), BlockFi urged a New Jersey federal judge to dismiss a proposed class action alleging the company sold unregistered securities to class members in violation of Section 5(a) of the Securities Act. In its motion to dismiss filed on July 7, [BlockFi argues](#) that the plaintiffs fail to plead injury or damages and do not state a claim, since they do not trace any of their alleged injuries to the challenged action by BlockFi. The company argues that even if the plaintiffs had been able to plead a conceivable injury, it would not have been the result of BlockFi failing to register its products as securities. The action was filed just weeks after BlockFi paid \$100 million to settle with state and federal regulators for alleged registration violations.
- In *Goines v. Celsius Network, LLC et al.*, No. 3:22-cv-04560 (D.N.J., filed July 13, 2022), the plaintiff sued Celsius Network LLC, two related entities, and several company executives in New Jersey federal court [claiming](#) that Celsius improperly earned the equivalent of \$10 billion from selling unregistered securities in a Ponzi-like scheme and induced investors to buy its financial products at inflated rates. According to the complaint, a downturn in the cryptocurrency market exposed the fact that Celsius, a cryptocurrency lending platform, did not have enough assets on hand to meet its withdrawal obligations. Plaintiff claims that Celsius products were unregistered securities offered and sold in violation of Section 12 of the Securities Act, and that Celsius committed fraud in the sale of these alleged securities.

2. Security Measures & Data Breaches

Class action litigation has continued to grow since last quarter, with a significant number of cases focused in particular on the data security offered to users of virtual

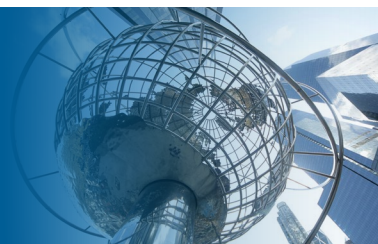
asset exchanges. For example, plaintiffs have lodged a range of claims against Coinbase on the basis of alleged data security failures. The mix of claims includes traditional civil claims such as breach of fiduciary duty, breach of contract and the implied covenant of good faith and fair dealing, unjust enrichment, and negligence, as well as statutory claims under the Electronic Funds Transfer Act, the California Uniform Commercial Code, the California Unfair Competition Law, and the California Insurance Code. In all three pending actions against Coinbase, plaintiffs accuse the exchange of “reckless disregard for security of clients’ assets” and of falsely representing to customers that it heavily invests in cyber security.

- Two cases allege that security shortfalls of Coinbase’s dual-factor authentication resulted in a failure to protect their assets. Hackers were able to intercept customers’ authentication codes and lock the account owners out, while Coinbase allegedly provided automated customer support that was unable to recognize or assist with signs of a compromised account. *Aramik Tarviridi, et al. vs. Coinbase Global, Inc. et al.*, No. 3:22-cv-04829 (N.D. Cal., filed Aug. 23, 2022); *Aggarwal v. Coinbase, Inc. et al.*, No. 4:22-cv-04829 (N.D. Cal., filed Aug. 23, 2022).
- Another complaint alleges that, after the lead plaintiff fell for an email phishing attack, Coinbase overlooked “obvious red flags signaling” suspicious account activity, such as “the fact that the activity was from a new IP address ... far away from Plaintiff’s home.” *Kattula v. Coinbase Global*, No. 1:22-cv-03250 (N.D. Ga., filed Aug. 15, 2022).

3. Breached Contracts & Broken Promises

- **Busted Deal Litigation.** Crypto merchant bank Galaxy Digital and crypto custody firm BitGo Holdings have entered into litigation after the two entities failed to close on a \$1.2 billion cash and stock acquisition that was billed as the biggest crypto deal of all time when it was announced. BitGo is seeking monetary damages pursuant to the parties’ contract but not specific performance to close the transaction. Galaxy’s motion to dismiss is expected on October 24, with briefing continu-

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



ing into December 2022. *BitGo Holdings Inc. v. Galaxy Digital Holdings Ltd. et al.*, No. 2022-0808 (Del. Ch., filed Sept. 13, 2022).

■ **Breach of Contract.** In *KeyFi Inc. v. Celsius Network Limited and Celsius KeyFi LLC*, No. 652367/2022 (N.Y. Sup. Ct., filed July 7, 2022), Jason Stone, CEO of KeyFi (a staking software and strategies firm), [sued Celsius](#) (a cryptocurrency lending company) for material misrepresentation, fraud, and breach of contract. The complaint alleges that Celsius failed to honor its contractual obligations to pay KeyFi “the millions of dollars it is owed pursuant to a profit-sharing agreement” for managing Celsius’ digital asset investments. This dispute reached a boiling point when KeyFi allegedly realized that Celsius was leveraging customer deposits to manipulate digital asset markets; had failed to employ accounting controls, which endangered the deposits; and did not execute various actions that induced KeyFi to undertake certain trading strategies. These oversights are alleged to have negatively impacted KeyFi’s profit share, and led to the termination of the contract.

4. Fraud & Misrepresentation

Beyond securities-based claims, a number of private actions related to digital assets have been filed based on traditional fraud principles.

■ **Romance Scams.** While investment scams continue to predominate crypto fraud losses, the so-called romance scams—in which scammers meet and then defraud victims through dating apps—are becoming increasingly prevalent. With \$185 million in reported cryptocurrency losses since 2021, that’s nearly one in every three dollars reported lost to a romance scam during this period. The FTC has [reported](#) that, since 2021, \$575 million of all crypto fraud losses reported to the FTC arose from bogus investment opportunities, far more than any other fraud type.

— For instance, in *Gadasalli v. Bulasa et al.*, No. 4:22-cv-00249 (E.D. Tex., filed March 28, 2022), the plaintiff sued crypto platforms Binance and Pol-

oniex, as well as several banks, over an alleged “par-amour scheme.” In her suit, the plaintiff alleges that a Tinder acquaintance fraudulently obtained access to her crypto assets, and that the platforms failed to prevent unauthorized transfers in violations of their own policies. She further contends that the banks—including Abacus Federal Savings Bank and TD Bank—continue to hold significant amounts of the funds that were improperly transferred.

■ **Alleged “Ponzi” Schemes.** In *Eisenberg v. Numeris*, No. 3:22-cv-01325 (D.P.R., filed July 6, 2022), Abraham Eisenberg sued Numeris Ltd., Sasha Ivanov and ten unnamed defendants, alleging that Eisenberg deposited over \$14 million worth of a cryptocurrency stablecoin into Vires Finance, a decentralized cryptocurrency finance protocol housed in the Waves blockchain ecosystem run by the defendants. Eisenberg’s complaint alleges that Waves and Vires engineered price spikes of its own token by buying it with USD stablecoin at high interest rates. Eisenberg argues that, after this alleged “Ponzi scheme” was revealed, the defendants implemented withdrawal limits and protocol changes that devalued his investment and have prevented him from withdrawing his assets, causing significant losses.

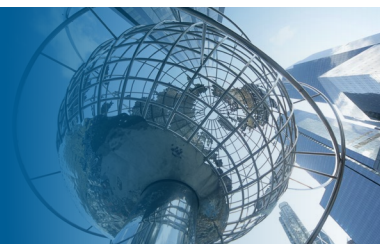
■ **IPOs and Misstatements.** In *Kocher v. Armstrong et al.*, No. 1:22-cv-01031 (D. Del., filed Aug. 4, 2022), plaintiffs allege that efforts by certain directors of Coinbase to increase the company’s user numbers in advance of its IPO backfired, and that investors who purchased shares in connection with the IPO unknowingly made an investment that was “substantially riskier than what had been represented in the registration statement.”

BANKRUPTCY

The growth of digital assets has led to emerging questions regarding the application of the U.S. Bankruptcy Code in crypto-custodian bankruptcy proceedings.

■ For example, in *Voyager Digital Ltd.*, No. 1:22-bk-10943 (S.D.N.Y., filed July 6, 2022) the court queried whether crypto assets held by an exchange should be considered

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



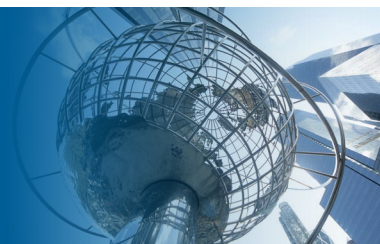
property of a bankruptcy estate. The Voyager bankruptcy petition, filed in the U.S. District Court for the Southern District of New York, shows Voyager has more than 100,000 creditors and listed between \$1 billion and \$10 billion in estimated cryptoassets, approximately equaling the amount of its liabilities. The presiding judge indicated that he has concerns about the status of cryptocurrency as an asset in a bankruptcy, while Voyager's counsel said the crypto deposited by customers is estate property under the terms of the deposit agreements.

- Further, to the extent crypto assets are property of the estate, crypto customers may be considered an unsecured claimholder of the debtor, such that their assets are not recoverable. This issue is implicated by *Patel v. Coinbase Global, Inc. et al.*, No. 1:22-cv-04915 (Bankr. D.N.J., filed Aug. 4, 2022), where a Coinbase investor has filed a class action complaint alleging securities laws violations on the grounds that Coinbase failed to disclose at the time of its IPO that it held crypto assets that could be subject to bankruptcy proceedings and that Coinbase customers would be treated as unsecured creditors of the company in that event. Patel seeks to represent a class of investors who bought or acquired Coinbase stock from the time of the IPO to July 26, 2022. Patel claims that those investors were misled by the company about the risks of bankruptcy and that, when those risks were publicly disclosed in May, the company's stock fell about 26%.
- In *In re Celsius Network*, No. 1:22-bk-10964 (Bankr. S.D.N.Y., filed July 14, 2022), the bankruptcy court authorized the U.S. Trustee to appoint an examiner in the Celsius bankruptcy cases. The examiner would provide an independent review of Celsius' assets, providing clarity where there is currently distrust concerning the company's disclosures. Historically, independent examiners of this nature have been used in significant bankruptcies such as *Enron*, *WorldCom*, *Dynegy*, and *Caesars*. Given the publicity surrounding the Celsius bankruptcy cases, we expect the U.S. Trustee and DOJ to keep a close eye on the examiner's report for cybersecurity and fraud-related issues.

- Celsius' bankruptcy litigation has given rise to at least three adversary actions: (1) *Celsius Network LLC et al. v. Prime Trust LLC*, Adv. Pro. No. 22-01140 (Bankr. S.D.N.Y. Aug. 23, 2022); (2) *Celsius Network Ltd. et al. v. Jason Stone and KeyFi Inc.*, Adv. Pro. No. 22-01139 (Bankr. S.D.N.Y. Aug. 23, 2022), and (3) *Ad Hoc Group of Custodial Account Holders v. Celsius Network LLC et al.*, Adv. Pro. No. 22-01142 (Bankr. S.D.N.Y. Aug. 31, 2022).

- In *Prime Trust*, Celsius has alleged that Prime Trust LLC (a fintech and digital asset infrastructure company) held crypto assets from Celsius' New York and Washington users from 2020 to mid-2021 without having any ownership rights over the assets. In June 2021, Prime Trust sent notice that it would be terminating its agreements with Celsius, acknowledging in a letter that it was contractually obligated to return the crypto assets transferred by the New York and Washington users that it held. Celsius argues that Prime Trust was obligated under the Bankruptcy Code to deliver Celsius property once Celsius declared bankruptcy.
- In *Jason Stone and KeyFi, Inc.*, Celsius filed a complaint against KeyFi Inc. and its CEO, Jason Stone, for allegedly losing and stealing thousands of Celsius coins, after allegedly misrepresenting that Stone and KeyFi could lead Celsius' plans for DeFi investments. Counsel for KeyFi has called Celsius' recent filing an "attempt for rewrite history" and use Stone and KeyFi as "a scapegoat for their organizational incompetence."
- In *Ad Hoc Group of Custodial Account Holders*, a group of "custody" wallet Celsius customers filed a complaint seeking a declaratory judgment that custody assets are not part of the Celsius bankruptcy estate. The complaint alleges the Celsius terms of service did not transfer title and ownership of custody assets to Celsius, and also appointed Celsius to act as an agent and custodian for custodial assets. If the bankruptcy court agrees with the custody customers, it could hold that custodial assets are not part of the Celsius bankruptcy estate that could be distributed to creditors.

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



LEGISLATIVE AND REGULATORY UPDATE

■ **Congressional Action.** In August, U.S. Rep. Raja Krishnamoorthi (D-Ill.) pressed federal agencies and crypto exchanges on consumer protection against digital asset frauds and scams. He sent letters to four agencies—the U.S. Treasury, SEC, CFTC, and FTC—and five crypto exchanges—Binance.US, Coinbase, FTX, Kraken, and KuCoin—about what the government and the exchanges are doing to protect consumers, and how this could inform potential legislative solutions to make the crypto space safer for consumers. While federal regulators struggle to assign oversight authority over digital asset markets among themselves, consumer protection may garner increased scrutiny from Congress.

— Meanwhile, the U.S. House [delayed consideration](#) of its proposed stablecoin regulation bill. As of September 2022, the terms of the draft bill were still being negotiated. U.S. House Financial Services Committee Chairwoman Maxine Waters (D-Calif.) and the committee’s Ranking Member, Patrick McHenry (R-NC), have been negotiating a bill that would give banks the ability to issue their own stablecoins—digital assets whose value is pegged to fiat currencies like the U.S. dollar—and put nonbank issuers under the oversight of the Federal Reserve. Both Reps. Waters and McHenry identified stablecoins as a top legislative priority in the aftermath of a President’s Working Group report warning that the tokens could pose systemic risks if they continue to grow unchecked. The same report encouraged lawmakers to pass legislation that would regulate the tokens like banks.

■ **Executive Action.** For its part, on September 16, the White House [released](#) a fact sheet, which it described as the “first-ever comprehensive framework for responsible development of digital assets.” This report comes in response to the Biden administration’s [Executive Order](#) on Ensuring Responsible Development of Digital Assets, which sought alignment between the various federal agencies and regulators involved in digital assets. The framework released last month is the culmination of nine reports submitted to the president since the March 2022

executive order, and outlines the administration’s priorities on a host of crypto-related fronts, including: fostering financial stability; countering illicit finance; protecting consumers, investors, and businesses; promoting access to safe, affordable financial services; advancing responsible innovation; reinforcing U.S. leadership in the global financial system and economic competitiveness; and exploring a central bank digital currency.

■ **State Action.** In California, Governor Gavin Newsom vetoed A.B. 2269, known as the Digital Financial Assets Law, which proposed a licensing regime for digital financial asset activity handled by California’s Department of Financial Protection and Innovation. Newsom characterized the proposal as “premature” in light of recent federal activity in Congress and by regulators concerning digital assets. He noted that his administration has been undertaking research and outreach related to digital asset regulation and would seek a “more flexible” approach to address trends and mitigate consumer harm.

LOOKING AHEAD

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

With a surge in digital asset bankruptcies, investors and lenders are left wondering where crypto fits into the U.S. Bankruptcy Code in crypto-custodian bankruptcy proceedings. As courts face these questions, the decentralized and pseudonymous nature of crypto investing may be at odds with the public nature of bankruptcy proceedings, suggesting that another forum for adjudicating these claims may be appropriate or necessary. Interested readers should monitor the *Patel* and *Voyager Digital* cases highlighted above for further developments on this front.

DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE



GLOBAL REACH

Ropes & Gray serves clients through a global network of offices in the world's major centers of business, finance, technology and government. Across 17 time zones, approximately 1,500 attorneys based in the United States, Europe and Asia collaborate seamlessly to provide clients with the high-quality representation and uncompromising, round-the-clock service that have made Ropes & Gray one of the world's premier law firms.

CONTACTS

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.¹

Melissa Bender

melissa.bender@ropesgray.com
+1 415 315 6340

Christopher Conniff

christopher.conniff@ropesgray.com
+1 212 596 9036

Daniel O'Connor

daniel.oconnor@ropesgray.com
+1 617 951 7260

Eva Carman

eva.carman@ropesgray.com
+1 212 596 9039

Helen Gugel

helen.gugel@ropesgray.com
+1 212 596 9398

Stefan Schropp

stefan.schropp@ropesgray.com
+1 212 596 9938

Mark Cianci

mark.cianci@ropesgray.com
+1 617 951 7122

Amy Jane Longo

amy.longo@ropesgray.com
+1 310 975 3269

¹Disclaimer: © Ropes & Gray LLP. Attorney advertising. This alert is intended for general information purposes only and should not be construed as legal advice or a legal opinion on any facts or circumstances. Any views or opinions expressed do not necessarily reflect the view or opinion of Ropes & Gray, its attorneys or its clients. Communication with Ropes & Gray LLP or a Ropes & Gray lawyer, including this alert, does not create a client-lawyer relationship. Prior results do not guarantee a similar outcome.

ROPES & GRAY
ropesgray.com

BOSTON | CHICAGO | HONG KONG | LONDON | LOS ANGELES | NEW YORK
SAN FRANCISCO | SEOUL | SHANGHAI | SILICON VALLEY | TOKYO | WASHINGTON, D.C.