

#### 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.

What a wild ride it was in 2022 for the cryptocurrency and digital asset industry. When the year began, crypto’s market cap was north of \$3 trillion, the non-fungible token (“NFT”) market was expanding, venture capital firms were lining up to invest in promising crypto businesses, and the industry enjoyed a receptive ear on Capitol Hill. Fast forward 12 months and the industry has seen the stunning fall of Terra USD and Luna, bankruptcies of numerous lenders, the headline-grabbing collapse of FTX, increased enforcement attention from federal regulators (which appears to be here to stay), and a now-uncertain legislative landscape in Congress and state capitals.

If 2022 was full of surprises for the sector, 2023 may well provide a gradual—if at times turbulent—path toward greater stability for the industry. Cryptocurrencies and digital assets are continuing to forge links with the traditional financial system and remain to many a promising asset class. And U.S. regulators, whether focused on the industry’s promise or pitfalls, are actively engaged. Below are the key takeaways from this quarter’s review and some predictions for what may come.

#### THE CRYPTO BOMBSHELL: FTX’S COLLAPSE

On November 17, 2022, FTX and FTX.US (along with numerous affiliates) [filed](#) for Chapter 11 bankruptcy in Dela-

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ware, a stunning development for a company that was not long ago one of the darlings of the crypto industry. The bankruptcy was set in motion in part by a report from *CoinDesk*, a crypto-focused news outlet, that an entity related to FTX (and also effectively controlled by FTX owner Sam Bankman-Fried), Alameda Research LLC (“Alameda”), held a significant amount of FTX’s native token, FTT, and that those comprised a sizeable portion of Alameda’s assets. Following the *CoinDesk* report, Binance, the world’s largest crypto exchange, announced it would sell its FTT holdings due to “recent revelations.” Binance’s announcement triggered a \$6 billion withdrawal run on FTX’s accounts, which the company could not fulfill. After an 11th-hour acquisition offer by Binance was withdrawn, FTX collapsed in one of the most shocking corporate downfalls in recent history. As described below, the legal fallout has been immense.

## 1. THE DOJ QUICKLY BRINGS CHARGES

- On December 13, 2022, less than a month after FTX filed for bankruptcy, the U.S. Department of Justice (“DOJ”) announced the unsealing of a [criminal indictment](#) charging Bankman-Fried with numerous crimes based on his management of FTX, including counts of conspiracy to commit wire fraud, wire fraud, conspiracy to commit securities fraud, conspiracy to commit commodities fraud, conspiracy to commit money laundering and conspiracy to defraud the Federal Election Commission. The DOJ’s indictment has little by way of details but is [notable](#) for the speed at which the charges were brought.

The DOJ’s case against Bankman-Fried may be bolstered by the guilty pleas and cooperation of Alameda’s former chief executive officer, Caroline Ellison, and FTX’s co-founder and chief technology officer, Gary Wang. On December 22, the DOJ [unsealed](#) Ellison’s and Wang’s guilty pleas, which included charges arising from their participation in schemes to defraud FTX’s customers and investors. Wang pleaded guilty to wire fraud, conspiracy to commit wire fraud, conspiracy to commit commodities fraud and conspiracy to commit securities fraud. Ellison pleaded guilty to two counts of wire fraud, two counts of conspiracy to commit wire fraud, conspiracy to commit commodities fraud, conspiracy to commit securities fraud and conspiracy to commit money laundering. Bankman-Fried was arrested in the Bahamas on December 12, extradited to the United States later in December, and then released on \$250 million bail—one of the largest bail amounts in recent memory. He now awaits his trial, which is tentatively scheduled for October 2023.

## 2. THE SEC AND CFTC ALSO TAKE ACTION

- **THE SEC CHARGES BANKMAN-FRIED WITH DEFRAUDING INVESTORS.** On December 13, 2022, the U.S. Securities and Exchange Commission (“SEC”) [filed](#) a civil complaint against Bankman-Fried, which contains significantly more detail about his alleged fraud than the DOJ’s criminal indictment. In that complaint, the SEC alleges that Bankman-Fried used fraudulent statements and his growing

public image to improperly obtain investor funds, which he allegedly diverted to his privately held crypto hedge fund, Alameda. The SEC seeks relief ranging from disgorgement to imposition of an officer and director bar for Bankman-Fried. Notably, the SEC’s complaint against Bankman-Fried did not allege a failure to register a sale of digital asset securities in violation of Section 5 of the Securities Act, which, as highlighted in a previous edition of this newsletter, has been a staple of SEC complaints against crypto participants in recent months. However, the SEC did make such Section 5 allegations against Bankman-Fried’s associates, Caroline Ellison and Gary Wang.

- **THE CFTC FOLLOWS SUIT.** The Commodity Futures Trading Commission (“CFTC”) also [filed](#) a civil complaint against Bankman-Fried, FTX.com and Alameda on December 13, 2022. The complaint alleges violations of Commodity Exchange Act antifraud rules based on FTX insiders’ alleged practices of (i) misappropriating customer funds by improperly diverting those funds to Alameda, (ii) allowing Alameda to maintain “an essentially unlimited line of credit on FTX” and (iii) permitting Alameda to enjoy unfair trading advantages relative to normal customers. Like the SEC’s complaint, the CFTC complaint alleges that Bankman-Fried and other FTX insiders used Alameda funds for unauthorized expenditures like luxury real estate and political contributions.
- **THE SEC WARNS OF DISCLOSURE OBLIGATIONS RELATED TO CRYPTO ASSETS.** In the weeks after FTX’s collapse, the SEC [issued](#) a press release warning companies involved in blockchain-related technologies of their disclosure obligations to investors. The press release recommended that issuers conduct a company-specific analysis of how “recent bankruptcies and financial distress among crypto asset market participants” may impact issuers’ companies and investments. The press release also describes companies’ reporting and disclosure obligations under Securities Act Rule 408 and Exchange Act Rule 12b-20, which require the disclosure of “further material information, if any, as may be necessary to make the required statements...not misleading.” The press release highlights the SEC’s increased focus on disclosure compliance in the cryptocurrency space.

For more detail on the SEC’s guidance regarding disclosure of crypto-related risks, see [this](#) client alert from Ropes & Gray.

### 3. IMPLICATIONS FOR PRIVATE LITIGATION

Following the collapse of FTX, U.S. and non-U.S. investors have filed multiple suits against Bankman-Fried and the celebrities who endorsed the platform. In general, the private litigation suits fall into one of several categories:

- **CLAIMS AGAINST CELEBRITY ENDORSERS OF FTX.** Investors have filed class-action lawsuits against big names—including Tom Brady, Larry David, Naomi Osaka and the Golden State Warriors—for fraudulent promotion of unregistered securities in the form of yield-bearing accounts (“YBAs”). *See, e.g., Garrison v. Bankman-Fried*, No. 1:22-cv-23753, (S.D. Fl., filed Nov. 15, 2022) (Miami class-action lawsuit claiming that FTX YBAs were a Ponzi scheme); *Podalsky v. Bankman-Fried*, No. 1:22-cv-23983 (S.D. Fl., filed Dec. 7, 2022) (consolidated with *Garrison* on Dec. 9, 2022).
- **PRIVATE LITIGATION AGAINST BANKMAN-FRIED AND HIS “INNER CIRCLE.”** The cases against Bankman-Fried and his inner circle generally advance claims that Bankman-Fried, Caroline Ellison, Gary Wang and others (i) used fraudulent or deceptive practices to misappropriate or convert digital assets, (ii) convinced consumers that their investments were safe, or (iii) directed and controlled a RICO enterprise. *See, e.g., Jessup v. Bankman-Fried*, No. 3:22-cv-07666 (N.D. Cal., filed Dec. 5, 2022) (alleging fraud, misrepresentation and conversion); *Hawkins v. Bankman-Fried*, No. 3:22-cv-07620 (N.D. Cal., filed Dec. 2, 2022) (alleging violations of California Unfair Competition and False Advertising Law, fraudulent concealment, and civil conspiracy); *Pierce v. Bankman-Fried*, No. 3:22-cv-07444 (N.D. Cal., filed Nov. 23, 2022) (alleging RICO violations).
- **PRIVATE LITIGATION AGAINST FTX’S BANK.** Silvergate Capital, the bank that allegedly facilitated the transfers between FTX and Alameda, is now facing two separate lawsuits by FTX users. The claims highlight two alleged failures by Silvergate: the failure to disclose lack of corporate controls and the failure to detect money laundering. *See Gonzalez v. Silvergate Bank*, No. 3:22-cv-01981-BEN-WVG (S.D. Cal., filed Dec. 14, 2022) (pursuing claims under common law for aiding breaches of fiduciary duty and

fraud); *Thomas v. Silvergate Capital*, No. 3:23-cv-00043-LL-NLS (S.D. Cal., filed Jan. 10, 2023) (pursuing claims under securities laws).

- **BANKRUPTCY LITIGATION.** In the wake of FTX’s collapse, restructuring expert John J. Ray III has taken over as CEO. In the United States, FTX.com, FTX US, Alameda and certain corporate affiliates commenced voluntary Chapter 11 bankruptcy cases in the District of Delaware on November 11. Meanwhile, Bahamian liquidators filed a Chapter 15 suit in the Southern District of New York for FTX Digital Markets, a Bahamian FTX entity. Liquidators claimed that FTX, which was headquartered in the Bahamas, was barred from filing for bankruptcy in the United States. As reported by *Reuters*, FTX affiliates have voiced distrust over the Bahamian process, with FTX attorney James Bromley explicitly stating, “We do not trust the Bahamian government.”

## ENFORCEMENT LANDSCAPE

### 1. REGULATORY TURF WAR CONTINUES

Both the SEC and CFTC have continued to ramp up enforcement activity relating to digital assets as the question of whether most digital assets transactions should be regulated by the SEC as securities or by the CFTC as commodities remains open.

- **THE SEC.** Chairman Gensler, who has said that the “[vast majority](#)” of crypto tokens and digital assets are securities, continues to maintain that existing federal securities laws empower the SEC to regulate crypto. The problem, in his view, is one of compliance. In a December 2022 [interview](#) with *Yahoo! Finance*, Chairman Gensler warned that the “runway is getting shorter” for companies issuing or selling crypto tokens to register with the SEC and comply with U.S. securities laws. He has promised that the agency will use “[all available tools](#)” to police the industry and has called for increased funding to better equip his agency to do so.
- **THE CFTC.** Chairman Behnam, for his part, has [not backed off](#) his position that most of the regulatory duties around cryptocurrencies should rest with the CFTC despite public criticism for what [some have called](#) an overly friendly

working relationship with Bankman-Fried during the latter's Washington, D.C. lobbying campaign.

## 2. ENFORCEMENT ACTIONS—THE SEC

- **THOR TECHNOLOGIES.** On December 21, 2022, the SEC [filed](#) a complaint in the Northern District of California against Thor Technologies, Inc. and its co-founders, David Chin and Matthew Moravec, for allegedly conducting an unregistered securities offering during its sale of “Thor Tokens.” Moravec has already settled for permanent and conduct-based injunctions, disgorgement of approximately \$72,000, and a \$95,000 civil penalty. The SEC’s complaint against Thor and Chin is pending, and it offers yet another opportunity for the SEC to argue that digital tokens constitute securities under *Howey*.
- **FORCOUNTRADER SYSTEMS.** On December 14, 2022, the SEC [charged](#) Forcount Trader Systems’ creator and promoters with violating securities registration requirements and antifraud provisions. The defendants allegedly sold “memberships” in Forcount’s purported (but actually nonexistent) crypto asset trading and mining operations. The SEC is seeking permanent injunctive relief, conduct-based injunctions, disgorgement of ill-gotten gains, civil penalties, and officer and director bars. The case is pending before the Southern District of New York.
- **LBRY, INC.** On November 7, 2022, Judge Paul J. Barbadoro of the U.S. District Court for the District of New Hampshire [granted](#) the SEC’s motion for summary judgment in its suit against LBRY, Inc. (“LBRY”), a blockchain-based video sharing platform. The SEC argued that LBRY conducted an unregistered securities offering when selling its “LBRY Credit” tokens to investors without filing a corresponding registration statement. LBRY maintained that its tokens were not securities and that it lacked fair notice of the purported application of U.S. securities laws to its tokens because the SEC’s prior enforcement actions in this context had focused principally on tokens characterized by an initial coin offering—a form of promotion that LBRY did not use. In agreeing with the SEC, Judge Barbadoro focused on representations and communications that LBRY made to the public, which the court concluded “led

investors to have ‘a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others’”—one of *Howey*’s key considerations. Judge Barbadoro’s opinion, though not binding on any other district court and specific to the facts of the case, nonetheless bolsters the SEC’s oft-contested enforcement authority in this space. It may have an impact on other pending cases that turn on whether the digital asset in question is a security and thus subject to the securities laws, including the closely watched case against [Ripple Labs](#), currently pending a decision on summary judgment, and the [Wabi](#) and [Sparkster Ltd.](#) cases, each of which has been discussed in a previous version of the newsletter.

- **TRADE COIN CLUB.** On November 3, 2022, the SEC filed a [complaint](#) in the Western District of Washington against a number of individuals for violations of securities registration requirements and antifraud rules arising from their alleged role in Trade Coin Club, a multilevel marketing program and Ponzi scheme. The SEC claims that Trade Coin Club promised investors a 0.35% daily return using a purported crypto asset trading bot but that no such bot existed, and that Trade Coin Club’s founder siphoned off millions of investors’ dollars to pay himself and his promoters. The SEC is seeking injunctive relief, disgorgement and civil penalties, and one promoter has already agreed to a [settlement](#).
- **ARBITRAGING.CO.** On November 3, 2022, the SEC [filed](#) a complaint against Jeremy K. Rounsville in the Northern District Court of Texas for his role in offering and promoting Arbitrating.co, an allegedly fraudulent crypto trading platform, in violation of Section 5’s registration requirements and the antifraud provisions of the Exchange Act. Rounsville consented to entry of judgment, and the SEC secured injunctive relief and a civil penalty of \$207,183.
- **YUGA LABS LLC.** On October 11, 2022, [Bloomberg reported](#) that the SEC is investigating Yuga Labs, the creator of the Bored Ape Yacht Club NFT Collection, to determine whether those NFTs are securities. If so, Yuga Labs may have breached federal law, as the Securities Act would have required Yuga Labs to qualify for an exemption from registration or otherwise file a registration statement prior to offering those NFTs to the public market.

- **ETHEREUM ENDORSEMENTS.** On October 3, 2022, the SEC [announced](#) charges against businesswoman and media personality Kim Kardashian. The SEC found that Kardashian failed to publicly disclose that Ethereum Max paid her \$250,000 before she posted to her 225 million Instagram followers “what [her] friends just told her about the Ethereum Max token,” specifically that Ethereum Max was reducing supply to give “back to the entire E-Max community.” Kardashian’s settlement agreement included \$1.6 million in civil penalties.

### 3. ENFORCEMENT ACTIONS—THE CFTC

- **COIN SIGNALS.** Back in January 2022, the CFTC had filed a complaint against Jeremy Spence, at times operating as “Coin Signals,” in the Southern District of New York for breaching various antifraud rules and regulations. This quarter, the court [entered](#) a consent order for a permanent injunction, restitution and equitable relief. Spence operated a virtual currency Ponzi scheme: over the course of 15 months, Spence fraudulently solicited over \$5 million in digital assets, including Bitcoin and Ether. After attempting to conceal his fraudulent conduct, he ultimately admitted his “lies and deceit” to customers.
- **DIGITEX FUTURES.** On October 3, 2022, the CFTC [filed](#) a complaint in the Southern District of Florida against Adam Todd and his Digitex-brand companies for violations of, among other things, the Commodity Exchange Act’s antifraud and market manipulation provisions, its unregistered transaction provisions, its merchant registration provisions under § 4(d), and its know your customer and anti-money laundering procedures. Todd operated a digital asset derivatives exchange, Digitex Futures, for U.S. customers. The complaint alleges that Todd knew that, because he reached out to customers, he was required to register, but failed to do so. The complaint further alleges that Todd attempted to manipulate DGTX, the exchange’s native currency, by requiring customers to deposit DGTX into their accounts to margin their trading on the futures exchange. Todd reportedly tried to “pump” the price of DGTX by deploying a bot to purchase large quantities of DGTX on other exchanges. The bot, which Todd de-

signed, was allegedly set to purchase more DGTX than it would sell.

- **OOKI DAO UPDATE.** In the CFTC’s action against decentralized autonomous organization (“DAO”) Ooki DAO in the Northern District of California, a federal judge recently [found](#) that the CFTC successfully served Ooki DAO by posting the complaint to an online discussion forum meant for DAO members and a help chat box on the DAO’s website. The judge, for purposes of addressing the limited issue of proper service, rejected broader arguments that a DAO is merely a technology that one cannot sue, holding that “fairness requires recognizing the DAO as a legal entity because as alleged in the complaint, the protocol itself is unregistered in violation of federal law, and someone must be responsible.” This case is among the first to address whether DAOs can be served with process and firmly corrects some who predicted that DAOs could exist in a jurisdiction-less vacuum without legal constraints.

### 4. ENFORCEMENT ACTIONS—THE DOJ

- **MAJOR SCHEMES.** The DOJ announced an [indictment](#) related to a major cryptocurrency fraud and money laundering conspiracy this quarter, continuing its focus on such increasingly complex scams. The defendants allegedly defrauded hundreds of thousands of victims by inducing them to enter fraudulent equipment rental contracts with their cryptocurrency mining service, HashFlare. Customers rented a percentage of HashFlare’s mining operations in exchange for the virtual currency produced by their portion of the operation, totaling more than \$550 million worth of HashFlare contracts between 2015 and 2019. According to the DOJ, the defendants also caused victims to invest in a virtual currency bank that was not an actual bank and that never paid out promised dividends, and allegedly used these shell companies to launder the fraud’s proceeds and enrich themselves.
- **ENFORCING PENALTIES.** The DOJ [sued](#) Larry Harmon, the founder of a cryptocurrency “mixer,” to recover a \$60 million civil penalty imposed on him in 2020 by the Financial Crime Enforcement Network (“FinCEN”), a bureau of the U.S. Treasury Department. FinCEN had alleged that

Harmon was operating an unlicensed money transmitting business in connection with Helix, a darknet-based cryptocurrency laundering service, in knowing violation of the federal Bank Secrecy Act (“BSA”). FinCEN said Harmon failed to “collect and verify customer names, addresses, and other identifiers” on more than 1.2 million Bitcoin transactions from June 2014 to December 2017, which were valued at the time at \$300 million. *United States v. Larry D. Harmon (d/b/a Helix)*, U.S. District Court for the District of Columbia, No. 1:22-cv-03203.

- **SDNY—A CRYPTO HOTSPOT.** This quarter, DOJ activity out of the U.S. Attorney’s Office for the Southern District of New York (“USAO SDNY”) grew significantly. In an unusual move, the criminal bank fraud investigation of Tether’s executives was [reportedly](#) reassigned within the DOJ and is now being led by the USAO SDNY. The federal investigation seeks to uncover whether Tether concealed the nature of its crypto-related transactions from the banks with which it was working during the early days of its business. Other major actions in SDNY this quarter include:
  - In November 2022, the USAO SDNY [announced](#) that James Zhong pled guilty to committing wire fraud in September 2012 when he unlawfully obtained over 50,000 Bitcoin from the Silk Road dark web internet marketplace by creating a string of Silk Road accounts in a manner designed to conceal his identity. He then triggered over 140 transactions in rapid succession in order to trick Silk Road’s withdrawal processing system into releasing approximately 50,000 Bitcoin from its Bitcoin-based payment system into his accounts. Law enforcement seized the Bitcoin in November, then valued at over \$3.36 billion, constituting the largest cryptocurrency seizure and the second largest ever financial seizure for the DOJ.
  - In December 2022, USAO SDNY [announced](#) charges against the founders and promoters of two cryptocurrency Ponzi schemes known as IcomTech and Forcount, the latter of which is also facing an SEC complaint, as noted above. Nine individuals were charged with conspiracy to commit wire fraud for their involvement in the scheme. IcomTech and Forcount were both purported cryptocurrency mining and trading companies that promised to

earn their respective investors impressive profits. In fact, neither company was engaging in cryptocurrency trading or mining at all, and the investments were used in furtherance of the schemes and to enrich the defendants. U.S. Attorney Damian Williams stated: “With these two indictments, this Office is sending a message to all cryptocurrency scammers: We are coming for you.”

## 5. ENFORCEMENT ACTIONS— OTHER DEPARTMENTS AND AGENCIES

- **U.S. TREASURY.** Earlier this year, the Treasury Department warned of a rise of laundering of illicit proceeds and sanctions skirting through the use of digital assets. This quarter, the department remained active in its enforcement activities.
  - On October 11, 2022, FinCEN [announced](#) that, in a coordinated effort with the Office of Foreign Assets Control (“OFAC”), it reached a global \$29,280,829.20 settlement with Bittrex for alleged violations of the BSA. The Treasury alleged that Bittrex did not maintain an effective money laundering program nor a viable suspicious activity reporting system, resulting in exposure to high-risk counterparties, including sanctioned jurisdictions, darknet markets and ransomware attackers. Bittrex allegedly relied on only a handful of employees with minimal anti-money laundering training and experience to manually review tens of thousands of transactions for suspicious activity daily. Over a three-year period, Bittrex allegedly conducted over 116,000 transactions valued at over \$260 million with entities and individuals located in jurisdictions subject to comprehensive OFAC sanctions.
  - In contrast, Payward, Inc. d/b/a Kraken (“Kraken”), a centralized virtual currency exchange operating in the United States and globally, reached a much smaller \$362,158.70 settlement with OFAC for apparent violations of the Iranian Transactions and Sanctions Regulations. According to the settlement [announcement](#), Kraken failed to implement appropriate geolocation tools, including an automated internet protocol (“IP”) address blocking system, and provided services to users

engaging in transactions on Kraken's platform while located in Iran. Kraken allegedly applied its geolocation controls only when onboarding customers, despite its global operations. In the settlement announcement, OFAC explained the relatively low settlement amount by indicating that the violations were "non-egregious" and crediting Kraken for having (i) voluntarily self-disclosed and (ii) promptly implemented automated blocking for IP addresses linked to sanctioned jurisdictions, along with other sanctions compliance tools. Kraken also implemented multiple blockchain analytic tools to assist with its sanctions monitoring.

- **FINRA.** In November 2022, the Financial Industry Regulatory Authority ("FINRA") [announced](#) that it is conducting a targeted sweep of examinations of approximately 20 brokerage firms it believes may be advertising cryptocurrencies to retail investors. FINRA stated it is interested in communications with retail customers about crypto products during the third quarter of 2022. Among other things, FINRA is requesting retail communications distributed or made available by brokers or their affiliates that relate to or concern a crypto asset or service. FINRA is allegedly concerned that firms are not properly communicating the risks of such investments and, in particular, not telling retail investors that they may have limited protection under current securities laws when investing in digital assets. FINRA leadership said that the "limited number of crypto-asset-related communications filed with FINRA by broker-dealer firms fail to comply with applicable standards at a significantly higher rate than communications for other products."

## PRIVATE LITIGATION

### 1. PRIVATE LITIGATION, CRYPTO TWIST

- **INVESTORS SUE OVER BITCOIN TRUST.** In *Fir Tree Value Master Fund L.P. v. Grayscale Investments*, No. 2022-1126 (Delaware Court of Chancery, filed Dec. 6, 2022), affiliates of hedge fund Fir Tree Capital Management LP filed a complaint against Grayscale Investments LLC and Grayscale Bitcoin Trust, seeking books and records premised on a concern that mismanagement and conflicts of interest have driven a nearly 50 percent discount to Grayscale's \$10.7 billion Bitcoin fund, GBTC. Grayscale wants to convert GBTC into an exchange-traded fund ("ETF"), a decision that the SEC rebuffed last June and that Grayscale is currently appealing.
- **CRYPTO LAW FIRM CONTROVERSY.** Kyle Roche, founding partner of crypto-focused law firm Freedman Normand Friedland LLP (formerly Roche Freedman), was caught claiming the existence of a secret pact with blockchain platform Ava Labs to sue its crypto competitors. In a video released by CryptoLeaks, Roche bragged that his job provided U.S. regulators "magnets" to go after and that he was "trading confidential discovery information for cryptocurrency." [The law firm later confirmed](#) that co-founder Roche left the firm following these accusations.
  - The controversy has impacted discovery in the firm's ongoing cases. Investors represented by Freedman Normand Friedland have sued Humbl Inc., a blockchain payment platform, in California federal court. Humbl asked a New York state court to order Freedman Normand Friedland to share and preserve evidence allegedly showing that the law firm paid a Twitter troll to malign the company. Freedman Normand Friedland denies the allegations. *Humbl Inc. v. Roche Freedman LLP*, No. 159867/2022, (N.Y. Supreme Ct., filed Nov. 16, 2022).
  - The comments by Freedman Normand Friedland's former partner may cause additional headaches for the firm. In a recent motion to dismiss a putative class action filed by Roche, crypto lender Nexo Capital Inc. has asked a court to toss the case, citing the former partner's remarks, among other reasons. Customers had sued Nexo for allegedly wrongfully suspending Ripple's digital asset, XRP. Nexo notes other cases already dismissed involving the firm, including the [market manipulation](#) suit against cryptocurrency exchange Bitfinex and stablecoin Tether. *Jeong v. Nexo Financial LLC*, No. 5:21-cv-02392 (N.D. Cal., filed Oct. 21, 2022).
- **CELSIUS ARGUES IT CANNOT CLAW BACK DIGITAL ASSETS IN BANKRUPTCY.** Recall from the last newsletter that the lending platform Celsius Network has asked a New York bankruptcy judge to keep custody over certain customer accounts to offset potential claims. Celsius [recently](#)

[argued](#) that cryptocurrency technology prevents the company from later clawing back assets it previously released, even if the court later assigns those assets to the company. Celsius gave users rewards for depositing digital assets, such as Bitcoin, in “Earn” accounts. But state financial regulators cracked down on the company, deeming the accounts to be unregistered securities. Celsius [filed for bankruptcy](#) in July.

For more detail regarding Celsius’ bankruptcy proceedings, see the [previous edition of this newsletter](#).

- **INVESTORS TURN TO SECURITIES LAWS TO RECOUP UNDERPERFORMING INVESTMENTS.** This quarter, aggrieved investors from California to Delaware are trying to unwind token sales and recover their losses. For example, investors have sued the crypto exchange Coinbase for allegedly operating as an unregistered broker-dealer of unregistered securities in violation of securities laws. [Flores v. Coinbase, Inc.](#), No. 2:22-cv-08274 (C.D. Cal., filed Nov. 12, 2022). Investors also sued DMA Labs for alleged fraud, market manipulation and the sale of unregistered securities in the form of “yield earning cryptocurrency.” [HASH Asset Management Ltd. v. DMA Labs, Inc.](#), No. 1:22-cv-01633 (D. Del., filed Dec. 23, 2022).
- **CRYPTO IS COMING TO THE SUPREME COURT.** Coinbase recently requested, and was granted, *certiorari* to determine whether appealing an unsuccessful motion to compel arbitration halts district court litigation pending appeal. [Coinbase, Inc. v. Bielski](#), No. 22-105 (pending 2022). Be sure to look for further updates in future installments of *Crypto Quarterly*.

## 2. FEDERAL REGULATION & BANKRUPTCY

As proponents of digital assets—and even [some government agencies](#)—decry attempts to “regulate by enforcement,” some law firms and crypto industry groups have attempted to clarify the scope of appropriate authority through litigation against various government agencies:

- **THE SEC.** One crypto-focused law firm has sought redress for the SEC’s purportedly unclear approach to regulating digital assets. In [Hodl Law PLLC v. SEC](#), No. 3:22-cv-

01832, (S.D. Cal., filed Nov. 21, 2022), Hodl Law, suing on its own behalf and on behalf of other Ethereum users, sought declaratory relief against the SEC “in the face of yearslong, purposeful delay and obfuscation by the defendant regarding its jurisdictional authority with respect to [digital assets].”

- **TREASURY DEPARTMENT.** Several groups have sued the Treasury Department for allegedly exceeding its authority by sanctioning cryptocurrency mixer Tornado Cash, an open-source privacy software that obscures the source of crypto payments.
  - For example, in [Coin Center v. Yellen](#), No. 3:22-cv-20375-TKW-ZCB (N.D. Fl., filed Oct. 12, 2022), crypto policy advocacy group Coin Center sued the Treasury Department’s OFAC, arguing that Tornado Cash is not a “person,” but rather is a “privacy tool beyond the control of anyone.” Coin Center argues that the International Emergency Economic Powers Act of 1977 allows the OFAC to sanction only “property in which some foreign country or national has an interest,” not a software tool like Tornado Cash.
  - In [Van Loon v. Yellen](#), No. 6:22-cv-920-ADA-JCM (W.D. Tex., filed Nov. 22, 2022), six crypto investors sued the Treasury Department for sanctioning Tornado Cash and listing the software on its Specially Designated Nationals and Blocked Persons List (“SDN”) list, which identifies entities that threaten or undermine U.S. foreign policy or national security. The filing states that the OFAC officials removed Tornado Cash from the list of entities threatening national security days before the lawsuit response deadline, and then, without explanation, relisted the company as one connected to North Korea. The investors claim that the OFAC overreached its authority.
  - Relatedly, just days after the OFAC sanctioned Tornado Cash in August 2022, Dutch authorities [arrested](#) the protocol’s alleged developer, Alexey Pertsev, putting into sharp focus questions about the legitimate uses of privacy tools. This past quarter, a Dutch court held a [hearing](#) that revealed additional details about the basis for the charges against Pertsev and renewed concerns around the world about the potential chilling effect on the industry if developers have reason to fear criminal exposure for writing



open source code. Notably, while the case has sparked a debate in the United States about whether executable code is a form of speech (and should be protected as such under the Constitution), there is no equivalent legal right to free speech in the Netherlands.

- **THE IRS.** Crypto industry groups hoped to use the tax refund case of *Jarrett v. U.S.* to clarify whether generating tokens through staking creates taxable income, but the IRS mooted the case by refunding the taxpayer what he claimed to be his overpayment amount. To keep the suit alive, the taxpayers, joined by the cryptocurrency policy group Coin Center, argued that the IRS should not be able to avoid litigation through a preemptory settlement and that the tax treatment of staking rewards was a recurring question and a question of public importance. The court agreed with the IRS and dismissed for lack of subject matter jurisdiction. The Jarretts plan to appeal to the Sixth Circuit to clarify taxation of crypto staking, according to a [notice](#) they filed in a Tennessee federal court. *Jarrett v. United States*, No. 3:21-cv-00419, 2022 WL 4793235 (Sept. 30, 2022).
- **THE FEDERAL RESERVE.** In *Custodia Bank, Inc. v. Federal Reserve Board of Governors & Federal Reserve Bank of Kansas City*, 2022 WL 16901942 (D. Wy. Nov. 11, 2022), the District Court of Wyoming must determine whether federal reserve banks have discretion to grant master account applications after a Wyoming crypto bank sought access to central bank funding. A Federal Reserve master account would give the bank access to central bank funding and the federal payment system to settle transactions. The case, which could dramatically change the way the Federal Reserve processes master account applications, has survived a motion to dismiss by the Federal Reserve.

### 3. INTELLECTUAL PROPERTY ISSUES

Although Shakespeare clearly was not reflecting on trademark law when he questioned “what’s in a name?”, blockchain companies have been questioning the importance of their names this quarter as trademark suits abound.

- For example, in *Tari Labs, LLC v. Lightning Labs, Inc.*,

No. 4:22-cv-07789 (N.D. Cal., filed Dec. 8, 2022), Tari Labs, LLC claimed that Lightning Labs, Inc.’s new platform, TARO, infringes on its trademark. Tari Labs manages a digital protocol for digital assets, including its own cryptocurrency, TARI tokens. While TARO does not provide identical services, Tari argues that the client demographic is similar, so users are likely to be confused by the names’ similarity. Tari requests that Lightning change the name of its new platform, disgorge any profits earned using the name and reimburse Tari’s legal fees.

- Block Inc., formerly known as Square, [sued](#) Bitcoin.com for trademark infringement in Germany. Bitcoin.com acts as the entry point for new users into the Verse tokenized digital ecosystem, which then sells the VERSE digital asset. The Bitcoin.com/Chainlink VERSE project has over 35 million wallets and five million active users. In 2020, Block acquired Verse Technologies Inc. and its mobile payments app, VERSE.
- On October 9, 2022, digital payments platform Cryptocarbon Global [appealed](#) a May 2022 award of £235,000 (\$288,000) in favor of Wirex after Cryptocarbon Global allegedly infringed Wirex’s trademark over Cryptoback, Wirex’s cryptocurrency rewards program. *Cryptocarbon Global Ltd. v. Wirex Ltd.*, No. CH-2022-000184 (High Court of Justice of England and Wales).

### LEGISLATIVE AND REGULATORY UPDATE

- **EXECUTIVE & CONGRESSIONAL ACTION.** In the wake of the FTX collapse, the Biden administration called on Congress to close gaps in cryptocurrency regulation. The Financial Stability Oversight Council, chaired by Treasury Secretary Janet Yellen, warned that digital assets could become more enmeshed in the traditional financial system, thereby posing a threat to the industry absent tougher oversight. After several high-profile U.S. Senate and House committee hearings intended to shine a spotlight on issues with FTX and digital assets generally, Congress’s appetite for moving on crypto legislation appears to be growing as the 117th congressional session gets underway. Several major crypto bills were percolating in Congress as 2022 came to an end, including:

- the Stabenow-Boozman-sponsored [bill](#), which would give the predominant regulatory oversight role to the CFTC;
- the Lummis-Gillibrand Digital Asset Bill, which, as Ropes & Gray attorneys [explained in a prior alert](#), would also give the CFTC regulatory power over most digital assets;
- a [bill](#) sponsored by U.S. Rep. Glenn “GT” Thompson (R-PA), which would also empower the CFTC as the primary regulator; and
- a [bill](#) co-sponsored by U.S. Senators Warren (D-MA) and Roger Marshall (R-KS) targeting money laundering in crypto and making some crypto participants subject to BSA rules, including know-your-customer (“KYC”) requirements, that apply to banks and traditional firms.

None of these have received a full vote of the Senate or House. And some of them face significant headwinds from advocates who believe that the SEC is better suited to play the role of top regulator. Several prior legislative efforts have also lost considerable momentum. The Stabenow-Boozman bill in particular may suffer from the “taint” of Sam Bankman-Fried’s influence over its drafting, and the Gillibrand-Lummis bill was designed as a largely theoretical “conversation starter.”

The House Financial Services Committee’s highly anticipated, bipartisan stablecoin regulation bill is currently the most promising effort. The legislation would establish rules for how stablecoin tokens such as Tether’s USDT and Circle Internet Financial’s USDC, which are tied to steady assets such as the dollar, can operate in the United States. That work was [reportedly](#) “almost to the finish line” by the end of the year, and its momentum is expected to continue, as a key negotiator of that effort, pro-crypto Republican Patrick McHenry, is the Committee’s incoming chairman.

- **STATE ACTION.** In October 2022, Louisiana’s Virtual Currency Business Act, standalone legislation regulating virtual currency activity in the state, was formally adopted and took effect January 1, 2023. In November 2022, California’s Attorney General Rob Bonta announced the launch of a [web-page](#) for consumers to learn about cryptocurrencies and how to avoid scams and other risks. In New York, the Federal Reserve Bank of New York [announced](#) a proof-of-concept program, in coordination with several major banks, to test the use of digital tokens representing digital dollars on a platform known as the regulated liability network, or RLN. New York Governor Kathy Hochul also signed onto law a two-year moratorium on new fossil fuel-powered cryptocurrency mining operations, which had been passed by the New York Senate in June 2022. The controversial measure creates a temporary pause on new permits for fossil fuel power plants that house proof-of-work cryptocurrency mining. While New York has become an attractive state for digital currency mining due to the availability of former power plants and manufacturing sites, the temporary ban is part of an effort to assess the environmental impact of digital asset mining and balance the state’s environmental and economic development goals.

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## CRYPTO QUARTERLY

### DIGITAL ASSETS, BLOCKCHAIN AND RELATED TECHNOLOGIES UPDATE

#### LOOKING AHEAD

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

With the advent of blockchain technology, electronic service has taken on a new meaning. In Italy, tech firm RBB Lab used NFTs on the Ethereum blockchain to serve summons on two defendants from their ex-employer, showcasing new uses for blockchain tech. See Tribunale Ordinario di Milano, n. #37371/2022 (It.). And, as noted above, a federal judge in California has ruled that service of process can be made on a DAO via an internet posting. It seems that traditional litigation and law enforcement processes are increasingly adapting to and relying on blockchain technology.

#### 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.<sup>1</sup>

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