

#### 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 LANDSCAPE

**SEC and CFTC Target Industry's Largest Exchanges, Continue Heavy Enforcement Activity.** On the heels of last quarter's dramatic collapse of FTX, then the second-largest crypto exchange in the world by trading volume, the Securities and Exchange Commission ("SEC") and Commodities Futures Trading Commission ("CFTC") have set their sights on some of the industry's largest and most established players, undertaking what some commentators have called a "[crypto carpet-bombing](#)." In the first quarter of 2023, the SEC and CFTC collectively brought (or strongly indicated that they would bring) enforcement actions against three of the industry's best-regarded crypto exchanges: [Coinbase](#), [Binance](#) and [Kraken](#).<sup>1</sup> (Another large exchange, KuCoin, was [sued](#) recently by the New York Attorney General.) On top of these headline-grabbing lawsuits, the SEC and CFTC have collectively filed over a dozen other crypto-related actions this quarter against individuals and entities. Read on for more.

<sup>1</sup> Rankings are per [Coinmarketcap.com](#)'s "Score" metric, which ranks crypto exchanges based on a number of criteria, including web traffic, average liquidity, trading volume and confidence that the reported volume is legitimate.

#### TABLE OF CONTENTS

■ ENFORCEMENT LANDSCAPE.....	1
■ REGULATORY ACTIONS.....	6
■ STATE ACTIONS.....	7
■ PRIVATE LITIGATION.....	8
■ CONTINUED FTX REPERCUSSIONS.....	11
■ LOOKING AHEAD.....	13

#### 1. ALLEGED UNREGISTERED TOKEN AND TOKEN PLATFORM UPDATES

- **SEC HITS COINBASE WITH WELLS NOTICE.** On March 22, 2023, SEC staff issued a Wells Notice stating that the staff is prepared to recommend an enforcement action against Coinbase based on Coinbase's alleged violations of the securities laws, including by allegedly operating as an unregistered securities exchange, an unregistered broker dealer and an unregistered transfer agent. The Wells Notice itself provided little detail beyond the proposed charges, but in its 8-K [filing](#), Coinbase asserted that the alleged violations relate to "aspects of the Company's spot market, staking service Coinbase Earn, Coinbase Prime and Coinbase Wallet." Further, according to a Coinbase [blog post](#), the SEC declined to identify any specific products or assets on the Coinbase platform it believes may be securities. Coinbase's blog post also reported that, during the SEC's nine-month investigation into the matter, Coinbase attempted to register with the SEC by presenting two registration models, and the agency was initially open to the idea. But before the SEC was slated to provide feedback on the registration models, the agency abruptly "cancelled...and told

[Coinbase] they would be shifting back to an enforcement investigation.” Coinbase maintains that it does not list or offer products that are securities under any legal standard, including the Supreme Court’s *Howey* test.

■ **Wahi Litigation Likely to Be Resolved Before Motion to Dismiss Ruling.** In a case that might have had significant implications for the SEC’s Coinbase matter, former Coinbase manager Ishan Wahi reached a proposed settlement in the agency’s civil lawsuit filed in the Western District of Washington. ([Ishan Wahi](#) and his brother [Nikhil Wahi](#) have both pleaded guilty to parallel criminal wire fraud conspiracy charges brought by the DOJ. The brothers’ close friend Sameer Ramani was also charged by the DOJ, but is still at large.) The proposed settlement would obviate a ruling on the motion to dismiss that Ishan Wahi had filed in February and in support of which Coinbase had filed an [amicus brief](#), criticizing the SEC’s practice of “regulation-by-enforcement.” The terms of the agreement will remain confidential unless and until it is approved by the SEC’s commissioners and entered as a judgment by the Court. The upshot is that the case is now unlikely to provide any additional clarity around the status (i.e., securities or not) of the Coinbase tokens identified in the SEC’s complaint. Be sure to check next quarter’s edition for another *Wahi* case update, and read more about overlaps between the *Wahi* case and Coinbase in our [Q3 2022](#) newsletter.

■ **SEC SETTLES WITH KRAKEN.** On February 9, 2023, the SEC [filed \(as a settled action\) a complaint](#) in the U.S. District Court for the Northern District of California (“N.D. Cal.”) charging Payward Ventures, Inc. and Payward Trading Ltd. (which do business under the name “Kraken”) with the unregistered offer and sale of interests in their crypto asset staking service program. The SEC’s complaint alleges that the staking service involved pooling investors’ assets and staking them on investors’ behalf. When staked, an investor’s tokens would become part of the blockchain data validation process, and the investor would be rewarded with additional tokens. Kraken allegedly touted its platform’s capabilities of generating investor benefits of up to 21% in annual returns. As part of the consent judgment filed with the complaint, Kraken settled the claims

by agreeing to cease their staking services and to pay \$30 million in disgorgement, prejudgment interest and civil penalties.

■ **CRYPTO TRADING PLATFORM BEAXY.** On March 29, 2023, the SEC [filed a complaint](#) in the U.S. District Court for the Northern District of Illinois (“N.D. Ill.”) against crypto platform Beaxy.com for simultaneously operating an unregistered exchange, brokerage and clearing business. This is the [first SEC action of its kind](#) against a Crypto platform and may serve as a template for future suits against similarly situated crypto firms. The complaint also names Beaxy’s CEO, Artak Hamazaspyan, and Beaxy Digital, Ltd., an entity that he controlled, for his role in raising \$8 million via an unregistered offering of the platform’s native token, Beaxy token (BXY).

■ **PAXOS TRUST CO.** On February 3, 2023, [Paxos Trust Co.](#) received a Wells notice from the SEC “recommending an action alleging that BUSD (a stablecoin associated with Binance pegged to the United States dollar) is a security and that Paxos should have registered the offering of BUSD under the federal securities laws.” On February 13, 2023, Paxos replied that they were “prepared to vigorously litigate if necessary.” Within days of Paxos’ public response, Binance CEO Changpeng Zhou tweeted that Binance would look to diversify stablecoin holdings away from BUSD. Shortly thereafter, Binance minted close to \$50 million in TrueUSD (TUSD), an alternative stablecoin. The SEC has not yet formally filed a complaint.

■ **GENESIS & GEMINI.** On January 12, 2023, the SEC [filed a complaint](#) in the U.S. District Court for the Southern District of New York (“S.D.N.Y.”), charging Genesis Global Capital LLC and Gemini Trust Company LLC with the unregistered offer and sale of securities to retail investors through the Gemini Earn Crypto asset-lending program. The lending program operated by agreement between Genesis and Gemini, whereby Gemini customers could loan their crypto assets to Genesis in exchange for Genesis’ promise to pay interest. Gemini, which acted as the transaction facilitator, deducted an agent fee from the returns Genesis paid to Gemini customers who participated in the lending program. In November 2022, Genesis prevented program participants from withdrawing their

assets because it lacked sufficient liquidity to meet withdrawal requests due to market volatility. This market volatility was undoubtedly connected to the FTX collapse.

## 2. ALLEGED FRAUDULENT SCHEMES AND OTHER VIOLATION UPDATES

- **CFTC FILES COMPLAINT AGAINST BINANCE.** On March 27, 2023, the CFTC [filed a complaint](#) in N.D. Ill. against Binance and related parties, including its CEO and Founder, Changpeng Zhao (“CZ”). The complaint alleges Binance failed to implement an effective compliance program and, at CZ’s direction, “instructed its employees and customers to circumvent compliance controls in order to maximize corporate profits.” The complaint further alleges that Binance told employees to communicate with U.S.-based customers via ephemeral messaging applications to avoid leaving evidence of these communications. Additional allegations include a failure to require customers to provide identity-verifying information and a failure to implement an effective anti-money laundering program. Specifically, the CFTC asserts a “lack of effective KYC [Know Your Customer] procedures or a CIP [Customer Identification Program] that would enable it to determine the true identity of its customers,” in alleged violation of the Bank Secrecy Act.
- **The SEC also has its sights set on Binance.** The agency attempted to block Voyager Digital’s bankruptcy plan whereby Binance-U.S. would purchase all of Voyager’s assets in a \$1.3B deal. The SEC’s [chief argument](#) was that VGX, Voyager’s native token, was akin to a security and that Binance was operating as an unregistered securities exchange. The bankruptcy judge rejected the SEC’s objections to the plan as too vague, and the plan was subsequently approved.
- **TRON FOUNDATION LTD.** On March 22, 2023, the [SEC announced](#) an enforcement action against Justin Sun and three of his wholly owned companies. The complaint was filed in S.D.N.Y. and alleges that Tron Foundation Limited, BitTorrent Foundation Ltd. and Rainberry Inc. engaged in the unregistered offer and sale of crypto as-

set securities. In addition to garden-variety unregistered security allegations, the SEC has also alleged fraudulent manipulation of the secondary market for Tronix (TRX) through extensive wash trading. The complaint alleges that Sun directed his employees to engage in more than 600,000 wash trades of TRX between two vehicles that he controlled. Between April 2018 and February 2019, Sun’s daily trades allegedly amounted to an average of between 4.5 million and 7.4 million TRX tokens.

- **TERRAFORM LABS & DO KWON.** On February 16, 2023, the SEC [filed a complaint](#) in S.D.N.Y., alleging that Terraform Labs and its CEO Do Hyeong Kwon (“Do Kwon”) orchestrated a multi-billion-dollar fraudulent scheme utilizing an algorithmic stablecoin. The SEC’s suit maintains that Terraform Labs, the issuer of the tokens Terra USD and Luna, operated the alleged scheme by offering and selling interconnected crypto tokens and assets. These assets allegedly included security-based swaps that paid returns by mirroring the price of stocks of U.S. companies, as well as Terra USD (UST), an “algorithmic stablecoin” that was supposed to maintain its peg to the U.S. dollar by being interchangeable for another of the defendants’ crypto assets, Luna. Do Kwon was arrested in late March in Montenegro, and the United States and South Korea have each requested extradition on parallel criminal charges. These proceedings follow the collapse of Terraform Labs’ various digital assets, as covered in our [Q2 2022 newsletter](#).
- **EISENBERG AND MANGO MARKETS.** On January 9, 2023, the [CFTC filed](#) a civil enforcement action in S.D.N.Y. against Avraham Eisenberg for his alleged participation in a fraudulent scheme utilizing “oracle manipulation.” According to the [complaint](#), Eisenberg misappropriated over \$110 million in digital assets by creating “two anonymous accounts on [decentralized finance platform] Mango Markets, which he used to establish large leveraged positions in a swap contract whose value was based upon the relative price of MNGO, the ‘native’ token of Mango Markets, and USDC, a stablecoin.” After establishing the leveraged position, Eisenberg allegedly artificially pumped the price of MNGO through rapid purchases of substantial quantities of MNGO on three separate crypto

exchanges that were inputs for the data feed that Mango Markets used to determine the value of Eisenberg's swap positions. Allegedly, this caused the price of MNGO to artificially spike 13 times in a 30-minute period. Eisenberg quickly liquidated his positions in an amount exceeding \$110 million dollars. Eisenberg has returned around \$67 million but retained over \$40 million. The USAO's office for the Southern District of New York is pursuing a parallel criminal case against Eisenberg.

### 3. RIPPLE LABS JUDGE REPORTEDLY CLOSE TO DECISION

- **RIPPLE LAWYERS ADVANCE BITTNER.** In its summary judgment briefing, Ripple has argued that the SEC's failure to clarify how the definition of a security applies to digital assets amounts to a lack of fair notice, a bedrock principle of American jurisprudence. In early March, Ripple attorney's submitted a [supplemental authority](#) filing to Judge Torres citing the Supreme Court's recent decision in [Bittner v. United States](#), 143 S. Ct. 713 (2022). In *Bittner*, an aggrieved taxpayer claimed that the IRS had imposed exorbitant fines calculated differently from the agency's public guidance. This, Justice Gorsuch said, "caused a serious fair-notice problem." In Ripple's recent letter to Judge Torres, it argued that the SEC's action similarly departed from public guidance.
- **COURT FILING IMPACTS CRYPTO PRICE.** After Ripple submitted filings advancing the Bittner case, commentators and investors [speculated](#) that Ripple might obtain a favorable ruling on summary judgment, causing the price of XRP to jump by over 10%.
- Adding to this speculation is the CFTC's recent complaint against Binance (see above). The complaint alleges that several major cryptocurrencies—Bitcoin, Ether and Litecoin—are commodities rather than securities, a position that is arguably inconsistent with the SEC's complaint against Ripple. Not only could this frustrate the SEC's case against Ripple, but it's also an example of the regulatory turf war we discussed [last quarter](#) playing out in high-stakes litigation.

### 4. ROLLING OUT THE RED CARPET: CELEBRITY CRYPTO ENDORSERS CONTINUE TO DRAW REGULATORS' IRE

As reported in the [Q1 2023 newsletter](#), 2022 saw a rise in regulatory activity aimed at celebrities' endorsement of cryptocurrency and other digital assets—a trend which has continued into 2023. In a [press release on February 17, 2023](#), the Director of the SEC's Division of Enforcement, Gurbir Grewal, stated that "the federal securities laws are clear that any celebrity or other individual who promotes a crypto asset security must disclose the nature, source and amount of compensation they received in exchange for the promotion." These statements were made during the [public announcement of charges against former NBA player Paul Pierce](#).

- **PAUL PIERCE CHARGED WITH VIOLATION OF ANTI-TOUTING SECURITIES LAWS.** On February 17, 2023, the SEC entered a [settlement order](#) against NBA legend Paul Pierce, who had been charged with violating anti-touting and antifraud provisions of the federal securities laws. The charges were filed in connection with Pierce's social media promotion of EMAX tokens. Pierce failed to disclose that he was paid more than \$244,000 worth of tokens in exchange for the promotional posts. Pierce agreed to pay \$240,000 in disgorgement and \$1,150,000 in penalties, and has agreed to not promote what the SEC described as "crypto asset securities" for the next three years.
- **EIGHT CELEBRITY PROMOTERS CHARGED IN SEC ENFORCEMENT ACTION.** In connection with an enforcement action discussed more above (see *Tron Foundation Ltd.*), (i) Lindsay Lohan, (ii) Jake Paul, (iii) DeAndre Cortez Way (Soulja Boy), (iv) Austin Mahone, (v) Michele Mason (Kendra Lust), (vi) Miles Parks McCollum (Lil Yachty), (vii) Shaffer Smith (Ne-Yo), and (viii) Aliaune Thiam (Akon) were simultaneously sued for illegally touting Tronix and BitTorrent ("BTT"). [According to the SEC](#), entrepreneur Justin Sun and his companies used special programs to direct "interested parties to promote the tokens on social media, join and recruit others to Tron-affiliated Telegram and Discord channels, and create BitTorrent accounts in exchange for TRX and BTT distributions." With the exception of Mahone and Soulja Boy, who are disputing the

claims against them, the named celebrities each paid more than \$400,000 in disgorgement and penalties, without admitting or denying the SEC's allegations.

## 5. DOJ CONTINUES TO TARGET INDIVIDUAL ACTORS

- **BITZLATO LTD.** Anatoly Legkodymov, the founder and majority owner of Bitzlato Ltd. (“Bitzlato”), a Hong Kong-registered cryptocurrency exchange that operates globally, [was arrested](#) in Miami on January 18, 2023. Federal prosecutors from the U.S. Attorney’s Office for the Eastern District of New York allege that he knew Bitzlato skirted U.S. regulatory safeguards and processed hundreds of millions of dollars worth of illicit funds. Although a small exchange, Bitzlato required minimal identification from its users, and marketed this aspect of the exchange. As a result of these allegedly deficient safeguards, the exchange allegedly attracted criminal proceeds and funds intended for use in illicit activity. By way of example, Bitzlato allegedly exchanged more than \$700 million in cryptocurrency with Hydra Market, an anonymous, illicit online “darknet” marketplace for narcotics, stolen financial information, fraudulent identification documents, and money laundering services that was shut down by U.S. and German law enforcement in April 2022.
- Legkodymov, a Russian national who resides in Shenzhen, China, is charged with conducting an unlicensed money transmitting business, as Bitzlato allegedly conducted substantial business with U.S. customers despite claiming it blocked U.S.-based customers. Assistant Attorney General Kenneth Polite, Jr. credited the DOJ’s nascent Cryptocurrency Enforcement Team, which we highlighted as a key new enforcement mechanism in the [Q3 2022 newsletter](#), and emphasized that the DOJ will continue “to combat cryptocurrency-fueled crimes, even if they transcend international borders.”
- The U.S. Treasury’s Financial Crimes Enforcement Network (“FinCEN”) is conducting a parallel enforcement action and announced an Order pursuant to section 9714(a) of the Combating Russian Money Laundering Act identifying Bitzlato as a “primary money laundering concern” in connection with Russian illicit finance.
- **CHIPMIXER.** On March 15, 2023, the U.S. Attorney’s Office of the Eastern District of Pennsylvania [charged](#) a resident of Hanoi, Vietnam in connection with the operation of Vietnam-based crypto mixer ChipMixer. Among other allegations, ChipMixer is said to have facilitated the laundering of \$17 million in Bitcoin connected to ransomware attacks, over \$700 million in Bitcoin connected to wallets flagged as containing stolen funds, and over \$200 million in Bitcoin associated with the dark net. Minh Quốc Nguyễn is the creator and operator of the online infrastructure used by ChipMixer and has been charged with money laundering, operating an unlicensed money-transmitting business, and identity theft. The government alleges that Nguyễn promoted ChipMixer and advised customers on how to avoid U.S. regulatory safeguards, such as know your customer and anti-money laundering measures. The government also alleges that ChipMixer serviced American customers without registering with FinCEN or collecting KYC and anti-money laundering data.
- **FORSAGE.** On February 22, 2023, a federal grand jury in the District of Oregon [indicted](#) four founders of Forsage, which marketed itself as a decentralized finance (“DeFi”) cryptocurrency investment platform. The government alleges that the founders, who are all Russian nationals, aggressively promoted Forsage to the public through social media as a real business opportunity but that, in reality, it was a Ponzi and pyramid scheme that illegitimately raised approximately \$340 million from investors. The founders have each been charged with conspiracy to commit wire fraud. The SEC had also initiated a lawsuit on August 1, 2022 against 11 individuals for their roles in creating and promoting Forsage, which was covered in the [Q3 2022](#) edition of this newsletter. In that action, the SEC charged the defendants with fraud and conducting an unregistered securities offering.

## REGULATORY ACTIONS

- The SEC has [proposed](#) changes to Investment Advisors Act Rule 206(4)-2. The proposal imposes requirements on investment advisors who have custody, or can obtain custody, of client assets. For example, it requires the advisors to keep the assets with a qualified custodian that has possession or control of the assets at all times for which the advisor has custody. More importantly, the proposed rule expands the definition of “asset” to encompass “funds, securities, or *other positions held in a client’s account*” (emphasis added). This sweeps up crypto assets.
- The SEC [acknowledges, however](#), that this rule change will likely present some regulatory uncertainty vis-à-vis crypto assets. For instance, “it may be difficult actually to *demonstrate* exclusive possession or control of crypto assets due to their specific characteristics (e.g., being transferable by anyone in possession of a private key).” Moreover, because most crypto assets are traded on platforms that are not qualified custodians, the SEC might argue (should the rule be adopted) that most advisers with custody of crypto assets would violate the custody rule upon trading them. Commissioner Mark T. Uyeda even [argues](#) that the proposal “mask[s] a policy decision to block access to crypto as an asset class.”
- Amid criticism from some federal lawmakers—[particularly Republicans](#)—over his agency’s campaign of enforcement against crypto firms, SEC Chairman Gary Gensler [testified](#) before the U.S. House Financial Services Committee on April 18, 2023. During the five-hour hearing, which was [focused](#) on congressional oversight of the SEC, Chairman Gensler responded to lawmakers’ questioning concerning the crypto industry and defended his agency’s approach to digital asset enforcement, stating “I’ve never seen a field that is so noncompliant with laws written by Congress and confirmed over and over again by the courts.” Rep. Patrick McHenry (R-NC), who has been among Gensler’s chief critics, used the hearing to argue that Gensler’s approach to recent enforcement has been overly rigid, amounted to regulation by enforcement, and has stifled legitimate business interests. Since the start of the 118th Congress, Rep. McHenry has [signaled](#) a strong interest in passing legislation that would provide a regulatory framework for digital assets. To that end, he created a [subcommittee](#) chaired by Rep. French Hill (R-AR) focused exclusively on digital assets.
- Chairman Gensler’s visit to Capitol Hill in April was his second in a matter of weeks. On March 29, 2023, he testified before the House Appropriations Committee and requested an additional \$200 million in funding for the SEC, [in part due](#) to the increased demands on the agency of regulating the digital asset arena. Rep. Steve Womack (R-AR) was critical of the SEC’s approach. Womack stated that, “[a]fter years of funding increases, we have an SEC that is heavy-handed with enforcement and examinations, and one that doesn’t think twice about proposing new regulations to completely rethink our markets.”
- An area of considerable focus for the industry and lawmakers alike is the SEC’s [Investor Alert](#) released on March 23, 2023, in which the SEC contended that “investments in crypto asset securities can be exceptionally volatile and speculative, and the platforms where investors buy, sell, borrow, or lend these securities may lack important protections for investors. The risk of loss for individual investors who participate in transactions involving crypto assets, including crypto asset securities, remains significant.” Some members of Congress may take issue with the alert’s impact on investor outlook and crypto firms’ bottom lines, while others may hope that it motivates Congress to take action.
- The **U.S. DEPARTMENT OF THE TREASURY** published a risk assessment report entitled [2023 DeFi Illicit Finance Risk Assessment](#), which is the world’s first illicit finance risk assessment conducted on what are broadly known as “DeFi services.” The report claims that bad actors such as cybercriminals, ransomware attackers, thieves, scammers and hostile foreign governments such as North Korea are able to exploit perceived vulnerabilities in DeFi services—including inconsistent implementation of measures to combat money laundering and terrorism financing—to transfer and launder illicit proceeds. The risk assessment identifies the scope of the issue, rather than providing recommendations to address it. It builds upon the Treasury’s other recent national risk assessments and is intended to

further the work outlined in Executive Order 14067 on “Ensuring Responsible Development of Digital Assets.” The assessment also includes a request for input from the private sector to inform next steps.

- The **BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**, the **FEDERAL DEPOSIT INSURANCE CORPORATION**, and the **OFFICE OF THE COMPTROLLER OF THE CURRENCY** issued a joint [statement](#) on January 3, 2023 on claimed crypto-asset risks to banking organizations. The statement communicates these agencies’ view that, based on the current understanding and experience of the agencies, “issuing or holding as principal crypto-assets that are issued, stored, or transferred on an open, public, and/or decentralized network, or similar system is highly likely to be inconsistent with safe and sound banking practices,” and that the agencies have “significant safety and soundness concerns with business models that are concentrated in crypto-asset-related activities or have concentrated exposures to the crypto-asset sector.” The statement notes that the agencies will continue to assess how crypto-asset-related activities, currently and in the future, can be conducted in a manner that is consistent with the soundness of the banking system, consumer protection, and compliance with applicable laws.

## STATE ACTIONS

- **NEXO CAPITAL INC. MULTISTATE SETTLEMENT.** The Q3 2022 edition of this newsletter reported on New York Attorney General Letitia James’s lawsuit, brought on September 26, 2022, against Cayman Islands-based cryptocurrency lending platform Nexo Capital Inc. (“Nexo”). The action charged Nexo with falsely claiming it was registered under state law while promoting and selling an interest-bearing virtual currency account called Earned Interest Product. In late 2022, a North American Securities Administrators Association (NASAA) working group, consisting of state regulators from California, Washington, Kentucky, New York, Oklahoma, Indiana, Maryland, South Carolina, Vermont, and Wisconsin, conducted an investigation into Nexo’s Earned Interest Product and concluded that it is a security. The working group helped negotiate a \$22.5 million [multistate settlement](#)

with 17 state regulators that was announced on January 19, 2023. Following the announcement, many additional states joined the settlement process. The SEC also reached a separate settlement with Nexo.

- **NEW YORK ENFORCEMENT.** New York’s Attorney General, Letitia James (“NYAG”), has brought a number of crypto-related actions this quarter:

- On February 22, 2023, CoinEx, a Hong Kong-based cryptocurrency exchange, was [accused](#) of transacting business illegally in failing to register as a commodity broker-dealer, securities broker or securities dealer before buying and selling tokens, in violation of New York’s Martin Act, a powerful blue sky law that has often been used to fight financial fraud. CoinEx allegedly also held itself out, without state permission, as a global cryptocurrency “exchange” and engaged in repeated and persistent fraudulent practices. According to the NYAG, CoinEx previously received a subpoena from the NYAG regarding its digital asset trading activities and did not comply.

- On March 9, 2023, the NYAG filed a [lawsuit](#) against Seychelles-based crypto exchange KuCoin for allegedly offering securities and commodities without registering as a securities and commodities broker-dealer, and for purportedly falsely representing itself as an exchange. The NYAG also alleges that KuCoin sells unregistered securities in the form of KuCoin Earn, its lending and staking product. Notably, while SEC Chair Gary Gensler has stated that the SEC may consider ETH to be a security, the NYAG’s lawsuit represents the first prominent court action in which a regulator has definitively claimed that ETH is a security. Through the lawsuit, the NYAG seeks to stop KuCoin from operating in New York and to block access to its website until it complies with applicable state registration requirements. KuCoin also allegedly failed to comply with a subpoena issued by the NYAG to provide information about its digital asset trading activities in the state. KuCoin is said to have already been found to be operating without proper licensure in multiple foreign jurisdictions, such as the Seychelles, Canada and the Netherlands.

■ On January 5, 2023, the NYAG filed a [lawsuit](#) against Alex Mashinsky, a co-founder and former CEO of cryptocurrency lending platform Celsius Network LLC and related entities (“Celsius”), for allegedly defrauding hundreds of thousands of investors, including New Yorkers. The NYAG alleges that Mashinsky made false and misleading statements about Celsius’s safety to encourage investors to deposit billions of dollars of cryptocurrency onto the platform, and misrepresented and concealed Celsius’s deteriorating financial condition. The lawsuit further alleges that Mashinsky failed to register as a salesperson for Celsius and as a securities and commodities dealer. The NYAG seeks to ban Mashinsky from doing business in New York and to require him to pay damages, restitution, and disgorgement.

■ **NEW YORK CONSIDERS ACCEPTING CRYPTO PAYMENTS FOR STATE-RELATED PAYMENT PURPOSES.** Legislators introduced New York Assembly Bill 2532 on January 26. It would allow cryptocurrencies to be accepted for payments to state agencies in certain circumstances. The bill does not address use of crypto for commercial payments. Under the proposed bill, an agency would be permitted to accept crypto for payments related to taxes, rent, fines, penalties and interest, for example, if the agency chose to do so. The bill specifically names Bitcoin, Ethereum, Litecoin, and Bitcoin Cash as acceptable currencies, but does not attempt to limit the acceptable currencies only to those named. The fate of the bill is not clear, as versions of the proposal have been introduced before, without success.

■ **ILLINOIS SEEKS TO IMPLEMENT LICENSING REGIME.** Illinois may follow in New York’s footsteps in implementing a cryptocurrency licensing regime similar to that of New York’s “BitLicense,” a business license of virtual currency activities that is issued by the New York State Department of Financial Services. A pair of bills is currently being considered by the Illinois legislature that would establish a crypto license for the state of Illinois, as well as consumer protection measures. The measures, developed by the Illinois Department of Financial and Professional Regulation (“IDFPR”), could put Illinois on par with New York in setting up comprehensive state-level crypto regulations. The legislation would require crypto firms to obtain licensing akin to New York’s BitLicense, and would

also establish trust companies that could handle custody of digital assets. Crypto exchanges and other virtual assets businesses would be required to undertake consumer protection efforts, including providing investment disclosures, protecting customer assets, implementing defensive measures against hacks, and shielding themselves against money launderers. A representative from IDFPR noted that the department seeks to develop a “complementary framework” among New York, Illinois, and California.

## PRIVATE LITIGATION

### PRIVATE LITIGATION, CRYPTO TWIST

■ **FRAUD CLAIMS FOR ALLEGED “RUG PULL” SCHEME.** An investor in influencer Logan Paul’s failed crypto gaming project, CryptoZoo, [is suing](#) Paul and his team for allegedly defrauding investors of millions of dollars through a “rug pull” scheme, in which developers attract funding by promising future benefits, but eventually abandon the project and keep the funds. [Holland v. CryptoZoo, Inc.](#) et al., No. 1:23-cv-00110 (W.D. Tex., filed Feb. 2, 2023).

■ The aggrieved investor claims that Logan Paul and his team failed to deliver the final project after investors had purchased the assets, leaving the investors with worthless tokens and no benefits. The investor also alleges that Paul and his team profited from the sales of CryptoZoo assets by buying the digital assets before publicly announcing the project and advertising it on social media.

■ **CELSIUS CUSTODY CASES SETTLE.** [Celsius Network](#) has reached a deal with the holders of its “Custody” accounts, allowing account holders who settle to immediately withdraw some of their cryptocurrency. A New York bankruptcy judge approved the settlement, which will give account holders more than 72 cents on the dollar. Celsius, an ad hoc committee of account holders, and the unsecured creditors’ committee called the deal a reasonable compromise. [In re: Celsius Network LLC et al.](#), No. 1:22-bk-10964 (Bankr. Ct. S.D.N.Y., filed Feb. 27, 2023).

■ **IS 2FA NOT ENOUGH?** A Coinbase customer is suing the cryptocurrency exchange for \$96,000 after identity

thieves withdrew funds from his account using a type of identity theft known as “SIM swapping.” The incident has sparked a debate in the crypto community about whether SMS two-factor authentication (2FA) should be used for account security, as it can be bypassed by SIM swapping. The customer claims that Coinbase refused to reimburse him for the loss of his funds, which he says represent 90% of his life savings. [Ferguson v. Coinbase, Inc.](#), No. 3:23-cv-01004-LB (N.D. Cal., filed Mar. 6, 2023).

### TRADEMARKS AND COPYRIGHTS

- ARE EXCLUSIVE TRADEMARKS ANTITHETICAL TO OPEN-SOURCE?** As we mentioned in our previous issue, blockchain software development firm Tari Labs sued Lightning Labs for trademark infringement over the use of the name “Taro” in December 2022. A judge issued a temporary injunction halting further development of Taro until it has been rebranded. In its [complaint](#), Tari argued that it and Lightning “compete in the same digital blockchain ecosystem, provide similar, and in some instances identical, goods and services, market to similar developers and users, and appear on the same blockchain platforms.” Some members of the open-source community have criticized the lawsuit, arguing that trademark enforcement is not appropriate in the context of free and open-source software. [Tari Labs, LLC v. Lightning Labs, Inc.](#), No. 3:22-cv-07789-WHO (N.D. Cal., issued Mar. 16, 2023).
- “META”-MARKS CAN’T SKIRT TRADEMARK LAW.** A Manhattan federal jury found that Mason Rothschild’s unauthorized NFT versions of Hermes’ Birkin Bags (“MetaBirkins”) violated the French fashion house’s trademark rights. The jury awarded Hermes \$133,000 in damages for trademark infringement, trademark dilution, and cybersquatting. Rothschild had argued that the works were protected by the First Amendment, while Hermes branded Rothschild a “digital speculator” whose NFTs interfered with its own planned offerings. Rothschild is expected to appeal the case. [Hermes International v. Rothschild](#), No. 1:22cv384 (S.D.N.Y., entered Feb. 14, 2023).

- TRADITIONAL BANKS SEEK TO DISSOCIATE FROM CRYPTO COUNTERPARTS.** Bank of America (“BofA”) has filed a complaint to cancel a trademark registration owned by a cryptocurrency company owner, who is also charged for his alleged role in a fraud scheme connected to the COVID-19 relief program. The trademark in question is “Bitcoin Bank America,” which covers cryptocurrency exchange services. BofA claims that the “Bitcoin Bank America” trademark is confusingly similar to its own registrations related to various banking, financial, and consulting services. This suit may signal an increase in similar trademark suits as traditional brick and mortar banks seek to distinguish themselves from cryptocurrency upstarts. Petition for Cancellation, [Bank of America Corp. v. Corona](#), No. 91284091OPP (T.T.A.B., filed Mar. 22, 2023).

### CLASS ACTION CASES AGAINST DIGITAL ASSET PARTICIPANTS

- BZX DAO N/K/A OOKI DAO.** A class action suit against bZx DAO, a decentralized autonomous organization (“DAO”), has survived a motion to dismiss in the Southern District of California. The court concluded that holders of governance tokens in a DAO may be members of a general partnership and have unlimited liability with respect to the DAO, based on certain facts including broad control to propose and vote on the DAO’s actions and authority to distribute profits to themselves. Under the Court’s decision, holders of governance tokens in a DAO that is a general partnership would all be general partners, regardless of whether they exercised their voting rights. The court suggested that a wrapped DAO, i.e., one organized under a recognized corporate form, would likely result in a different conclusion. [Sarcuni v. bZx DAO et al.](#), No. 22-cv-618-LAB-DEB (S.D. Cal., filed Mar. 27, 2023).
- In the class action against bZx, the court allowed the plaintiffs, who were victims of a \$55 million hack in 2021, to sue not only the bZx leadership but also the governance-token-holding members of the bZx DAO. In its parallel enforcement proceeding, the CFTC also found that membership in the bZx DAO could poten-

tially expose such individuals to legal liability.

- **DAO CASE DISMISSED.** On February 22, a U.S. District Court Judge dismissed a class-action lawsuit claiming that Maker Ecosystem Growth Foundation (“Maker”), one of the world’s largest decentralized finance protocols, had misrepresented risks and caused investors to lose \$8 million. [\*Johnson v. Maker Ecosystem Growth Holdings, Inc., et al.\*](#), No. 3:20-cv-02569-MMC (N.D. Cal, issued Feb. 22, 2023).
  - The lawsuit, filed in April 2020, alleged that Maker had falsely represented collateralized debt positions on the platform as more secure than other investments. Maker was later dissolved as part of a decentralization strategy in which operations were transferred to MakerDAO.
  - Judge Maxine Chesney held that Maker is not a proper defendant since it has been dissolved and therefore lacks capacity to be sued. Judge Chesney added that, even if Maker were a proper defendant, the complaint would still fail to meet the heightened pleading standard for fraud since it describes various defendants (i.e., Maker Growth and Metronym, the new Cayman Islands-based operator of the DeFi platform) interchangeably.
- **CRYPTO MINING ISSUES.** This past quarter experienced renewed attention to cryptocurrency mining, particularly its [environmental and economic impact](#). Several cases raised novel legal issues related to this practice as well.
  - **Don’t Misrepresent How Hard Mining Is.** Investors in Argo Blockchain PLC have filed a proposed securities class action in New York federal court, claiming that the company’s IPO documents were “negligently prepared” and included misleading statements that concealed difficulties in mining cryptocurrency. The suit seeks to represent all those who bought stock in the company between its IPO in September 2021 and October 2022, alleging that the business was “less sustainable” than investors were led to believe. The lawsuit claims that Argo was facing network difficulties, increased electricity prices, and capital constraints, among other infrastructural and financial woes, which purportedly were not disclosed in its public statements. [\*Murphy v. Argo Blockchain PLC, et al.\*](#), No. 1:23-cv-00572 (E.D.N.Y., filed Jan. 26, 2023).

- **Crypto Mining May Violate Climate Laws.** The Clean Air Coalition of Western New York and the Sierra Club sued the New York Public Service Commission (PSC) for approving the transfer of a fracked gas power plant to a 24/7 cryptocurrency mining operation owned by Digihost International. The lawsuit is based on claimed violations of New York’s Climate Leadership and Community Protection Act and is the first to demand that a state agency follow the legal obligations established by New York’s landmark climate law. The PSC’s approval of the mining operation allows Digihost to increase its greenhouse gas emissions by up to 3,500%, despite New York generally working to reduce emissions. The approval comes after the New York Department of Environmental Conservation denied a Title V Air Permit renewal for Greenidge Generation, another crypto mining facility. On November 22, 2022, Governor Hochul had signed a two-year moratorium on new and renewed permits for fossil-fueled power plants that produce their own energy to mine crypto, and Earthjustice and the Sierra Club had also released a comprehensive report on perceived negative environmental impacts of cryptocurrency mining in the United States. [\*Clean Air Coalition of Western New York, Inc. and Sierra Club v. New York State Public Service Commission et al.\*](#), No. 900457-23 (N.Y. Sup. Ct. Albany Cnty., filed Jan. 13, 2023).

#### ■ NFTS—UNREGISTERED SECURITIES?

- A class action lawsuit claims that DraftKings is dealing in unregistered securities in violation of federal and state law. The lawsuit claims that the fantasy sports betting service had knowledge that certain NFTs it sold were securities under securities laws but failed to register them. The NFTs at issue are unique digital identifiers that certify ownership of digital items of sports memorabilia, art, music, or video, and are traded on the DraftKings Marketplace. Investors, including retail investors, allegedly suffered significant damages “due to the Defendants’ issuance, promotion, and sale of unregistered securities.” [\*Dufoe v. DraftKings Inc., et al.\*](#), No. 1:23-cv-10524 (D. Mass., filed Mar. 9, 2023).

- In another class action lawsuit against Dapper Labs for its NFTs called “Moments,” the Court denied the defendants’ motion to dismiss, holding that Moments may be securities under the *Howey test*, which considers (1) an investment of money (2) in a common enterprise (3) with the expectation of profit based on the efforts of others to qualify as an “investment contract” subject to securities laws. [\*Friel v. Dapper Labs, Inc., et al.\*](#), No. 1:21-cv-05837-VM (S.D.N.Y. issued Feb. 22, 2023).
- In analyzing the second prong of the test, the court ruled that the plaintiffs had adequately alleged horizontal and broad vertical commonality because, respectively, funds obtained from sales were pooled together and the Moments holders’ profits were tied to Dapper Labs’ overall success. However, the court found that strict vertical commonality was not adequately alleged since Dapper Labs could profit independently from the Moments holders.
- The court also found that Moments holders had a reasonable expectation of profit based on the efforts of others, given that Dapper Labs had touted the NFTs as a potential investment opportunity and that Moments can only be traded on the Flow blockchain that Dapper itself maintains.
- The court emphasized that its decision was based on the specific facts of the case and should not be seen as a general endorsement that NFTs are always or usually securities.

### LEGAL CRYPTO GAINS MOMENTUM

- As prefaced in our previous edition, blockchain continues to solidify its place in the courtroom by enabling and enforcing court processes.
- **NFTs—The Future of Service?** A Florida federal judge entered a default judgment in favor of a man who used a non-fungible token (NFT) to serve complaints to over a dozen unidentified suspects in an attempt to recover nearly \$1 million in stolen cryptocurrency. The judgment marks the first time that someone has won a default judgment after using an NFT to serve notice of a complaint.

[\*Bandyopadhyay v. Defendant 1 et al.\*](#), No. 1:22-cv-22907-BB, filed Mar. 7, 2023).

- **Legal Crypto Tech Now Enables Court Orders.** A federal court has issued a restraining order to freeze certain criminal accounts on the JuratBTC blockchain containing JTC cryptocurrency, after miners filed a suit to prevent the network from being misused. The accounts are controlled by 16 individuals and criminal organizations sanctioned by the U.S. Treasury Department for various crimes. JTC is a consumer protection version of bitcoin created through a fork of the bitcoin blockchain that updated the software with court connection technology. Jurat technology connects blockchain nodes with court dockets to enforce court orders, while remaining decentralized and ensuring that no government official has control over it. [\*JuratBTC Blockchain v. Andreyev et al.\*](#), No. 1:23-cv-00779 (N.D. Ill., filed Feb. 8, 2023).

### CONTINUED FTX REPERCUSSIONS

- **ARE BAHAMIAN FUNDS OUT OF REGULATORY REACH?** Bankrupt crypto exchange FTX has sued the liquidators overseeing the wind-down of its Bahamian affiliate, FTX Digital Markets, accusing them of falsely claiming ownership of the exchange’s assets. FTX Trading has asked a U.S. bankruptcy judge in Delaware to rule that FTX Digital Markets had no ownership interest in FTX.com’s cryptocurrency, intellectual property, and customer relationships. The Bahamian affiliate was reportedly a “corporate shell” and the “centerpiece” of founder Sam Bankman-Fried’s effort to “funnel FTX Trading customer deposits and other valuable property and rights to the Bahamas, out of the reach of American regulators and courts,” according to the lawsuit. [\*In re: FTX Trading LTD., et al.\*](#), No. 23-50145-JTD (Bankr. D. Del., filed Mar. 19, 2023).
- FTX Digital Markets liquidators claimed that FTX’s business plan and changes in FTX.com’s terms of service showed that FTX intended to migrate existing international customers to FTX Digital Markets. FTX has disputed this claim, stating that FTX Digital Markets never provided significant services for the exchange business

and that the change in FTX.com's terms of service did not transfer any property or responsibility to FTX Digital Markets.

- **FTX SEEKS TO CLAW BACK TRANSFERRED FUNDS.** FTX filed a motion in the Delaware Bankruptcy Court to approve a proposed settlement that would enable the defunct exchange to claw back over \$404 million that was transferred to hedge fund Modulo Capital prior to FTX's collapse. The deal would see the hedge fund return 97% of the \$475 million transferred by Alameda Research before FTX's bankruptcy, with Modulo Capital releasing \$56 million in claims against FTX's estate and returning approximately \$404 million in cash, thus delivering \$460 million in value to stakeholders. *In re: FTX Trading Ltd., et al.*, No. 22-11068-JTD (Bankr. D. Del., filed Mar. 22, 2023).

- **SEC/CFTC ENFORCEMENT OF NISHAD SINGH.** On February 28, 2023, the [SEC](#) and the [CFTC](#) filed parallel complaints in S.D.N.Y. against Nishad Singh, a former FTX computer engineer. The SEC's complaint alleges that Singh was an active participant in FTX's scheme to defraud investors by virtue of a software code he developed. This software allowed FTX to transfer investor funds to Alameda Research, an entity also controlled by ex-FTX CEO Sam Bankman-Fried, before FTX's liquidity problems became publicly known. The complaint further alleges that, after Bankman-Fried and Singh became aware they could not honor customer withdrawal requests, they continued to use the software to divert customer funds. Allegedly, Singh withdrew approximately \$6 million in these diverted funds for personal use. The CFTC's complaint also alleged fraud under a theory of aiding and abetting. These [complaints were filed on the same day](#) that Singh pled guilty to three counts of criminal fraud in S.D.N.Y. Singh did not contest the CFTC and SEC's complaints, agreeing to a consent order with the former and a bifurcated settlement with the latter.

Q1 2023

## 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 and enforcement lawyers working in the field. This quarter's featured insight:

As U.S.-based crypto industry leaders brace themselves for increased regulatory crack-downs—especially from the SEC and CFTC—in contrast, regulators from “across the pond” have signaled a proactive, positive regulatory environment designed to foster cryptocurrency technology. For example, for Gundars Ostrovskis (Team Lead, Digital Finance at the European Commission and panelist at Paris Blockchain Week), regulation is “something that could help innovation and could help the popularity of the technology.”

This policy strategy of fostering crypto through regulation is exemplified in an unprecedented, wide-ranging piece of legislation designed to regulate crypto-asset-related activities in the EU, called Markets in Crypto-Assets Regulation (“MiCA”). A final vote on MiCA regulation is expected in April 2023.

#### 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>

**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

**Amy Jane Longo**

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

**Mark Cianci**

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

**Stefan Schropp**

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

# ROPES & GRAY

ropesgray.com

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

© 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. 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. 23\_0619\_0424