Investors Accuse Crypto Firms of Illicit Token Sales

04/07/20

(Excerpts from this piece were originally published in Law360)

Investors filed a barrage of proposed securities class actions against four crypto-asset exchanges and seven digital token issuers for allegedly offering and selling billions of dollars worth of unregistered tokens, according to 11 suits brought in New York federal court late Friday.

While there have been several one-off cases in the past against coin issuers and exchanges over the unregistered sale of tokens as securities, this is the first coordinated effort to push major crypto firms to follow federal and state securities laws, according to a source familiar with the matter.

The investor plaintiffs, all represented by Selendy & Gay and Roche Cyrulnik Freedman, seek to redress manipulative behavior by exchanges and issuers taking advantage of market enthusiasm for crypto assets following the success of bitcoin and ethereum, the firms said Monday in a joint statement.

Philippe Selendy compared the crypto firms' alleged misconduct and profits gained through "a basic betrayal of public trust" to the 2008 mortgage crisis.

"The crypto-asset market has exploded in the last few years with ICOs that make great promises but deny investors critical information on the securities sold," Selendy said. "The lawsuits we filed seek to restore integrity and transparency to these new financial markets."

The suits target crypto-asset exchanges Binance, Bibox, KuCoin, and HDR Global Trading Ltd (which operates BitMEX), and token issuers Tron Foundation, Block.one, BProtocol Foundation (also known as Bancor), Civic Technologies Inc., KayDex Pte. Ltd. (also known as Kyber Network), Quantstamp Inc., and Status Research & Development GmbH, along with several of their executives.

All of the defendants face strict liability claims that they offered and sold unregistered securities. The exchanges also face unregistered broker-dealer claims, and BitMex faces additional allegations of market manipulation in violation of the Commodity Exchange Act, court records show.

Individual investors Chase Williams, Alexander Clifford, William Zhang and Eric Lee, on behalf of the proposed investor classes, allege that the companies took advantage of the “Wild West” atmosphere of initial coin offerings in 2017 and 2018, before the U.S. Securities and Exchange Commission issued its April 2019 guidance deeming digital tokens securities.

According to the suits, the only offering information available to investors who were considering buying tokens were “whitepapers” published by the coin issuers. These whitepapers described the purported utility of a token in highly technical terms, “preying on” the investors’ lack of familiarity with the underlying technology, the investors said.

“These whitepapers would often omit, however, the robust disclosures that the securities laws and the SEC have long codified as essential to investor protections in initial public offerings, including use of ‘plain English’ to describe the offering,” the investors said in the Binance complaint.

Other required disclosures missing from the whitepapers include a list of key risk factors, warnings about relying on forward-looking statements, and an explanation of how the funds from the ICO would be used, the investors claim.

Token issuers would launch an ICO and then quickly move to list their coins on exchanges like Binance to reach a wider investing audience, the investors said. Once the exchanges agreed to list a particular token, they would then take over promotion for that token and make millions of dollars in profits, according to the suits.

For example, Binance, which the investors describe the largest crypto exchange in the world, would reap profits from transaction fees for trades carried out on its exchange, as well as large cash payments from token issuers — sometimes upwards of $1 million — in return for listing their coins, according to that suit.

Issuers and exchanges both took care to convince investors that the tokens were not securities by stating that plainly in their whitepapers, refusing to register with the SEC, or misleadingly comparing their tokens with bitcoin, a cryptocurrency that the SEC considers to be a commodity and therefore does not have to be registered with the regulator as a security, the investors said.

For example, Tron, which sold TRX coins, did not register with the SEC as a security even though it doesn’t qualify for an exemption, and its whitepaper “expressly stated that ‘TRX is not a security,’” according to that suit.

Before April 2019, investors would have no way to discern whether TRX coins were securities if they went by Tron’s offering materials, they said.

Tron also misled investors to believe its tokens were “utility tokens” — which can only be used for a specific already-functioning product or network — rather than “security tokens,” which are bets on, or investments in, the future functionality of a network, the investors claim.

“TRX tokens are securities because they constituted an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others,” the investors said.

The suits reference the SEC’s September 2019 action against major token issuer and current defendant, Block.one, which agreed to pay a $24 million penalty to the regulator for its unregistered offering. Block.one’s EOS tokens are “functionally identical to TRX,” investors in the Tron suit said.

“The SEC’s determination that EOS is a security applies with equal force to TRX,” they added.

But because the token buyers were unaware of the risks involved with purchasing such securities, they have “suffered significant damages” as the value of these tokens plummeted, according to the suits.

“The promises of new products and markets went unfulfilled, with the networks never fully developed, while investors were left holding the bag when these tokens crashed,” the investors alleged. “Indeed, all of the Tokens are now trading at a tiny fraction of their 2017–2018 highs.”

Selendy & Gay and Roche Cyrulnik also represent investors in the high-profile $1.4 trillion consolidated case against cryptocurrency companies Tether and Bitfinex over their alleged manipulation of the bitcoin market.

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