Wave Of Suits Could Lead To New Era In Crypto Litigation

04/10/20

A flood of securities class action complaints filed last week in New York federal court against a host of digital asset exchanges and issuers may foreshadow a new phase in fintech litigation, building on a flurry of targeted actions and guidance over the past year.

The plaintiffs, represented by Selendy & Gay and Roche Cyrulnik Freedman LLP, took aim at four exchanges and seven issuers that they claim took advantage of market enthusiasm following the success of Bitcoin and Ethereum and failed to adhere to federal and state securities laws. The suits were filed on April 3 in the Southern District of New York.

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

"Any issuer or exchange in the space now has to anticipate that there will be heightened scrutiny over exactly what they're selling investors," Philippe Selendy, a lead partner representing the plaintiffs in the cases, told Law360. "And the SEC framework approach, which was put in place a little over a year ago, is going to be much more scrupulously studied by litigators on behalf of investors."

All of the defendants face claims that they offered and sold unregistered securities. The exchanges also face unregistered broker-dealer claims, and BitMEX faces allegations of market manipulation in violation of the Commodity Exchange Act.

A New Wave of Litigation

These 11 suits come on the heels of a decision at the end of March in a widely followed case that the U.S. Securities and Exchange Commission brought against Telegram blocking the distribution of its Gram tokens. A New York federal judge ruled that Telegram's offering of its Gram tokens, through the distribution of the tokens themselves, constituted a securities offering, striking a blow to the structure used by Telegram and others.

Over the past year, the SEC has become more active in bringing suits against digital-asset companies and has provided some guidance as to how securities laws should be applied to the novel asset class. Selendy & Gay and Roche Cyrulnik are also lead counsel in a $1.4 trillion consolidated class action alleging that Bitfinex and Tether, two large players in the industry, manipulated the Bitcoin market.

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 SEC issued its April 2019 framework outlining how it would assess the application of federal securities laws and what is known as the Howey test to digital assets.

The Howey test stems from a 1946 U.S. Supreme Court case that broadly interprets the term "investment contract" under the Securities Act as an agreement in which a person invests money in a common enterprise, expecting profits based on the efforts of others.

Focus on Howey and ERC-20

All 11 complaints walk through an analysis of how an issuer's tokens or tokens offered on an exchange fit within the bounds of the Howey test and should therefore adhere to federal securities laws. A common thread throughout each complaint is that they all address ERC-20 tokens, a type of smart-contract token built on the Ethereum blockchain that follows a basic set of standards.

The suits reference the SEC's September 2019 action against Block.one, a major token issuer and defendant in the present class actions, which agreed to pay a $24 million penalty to the regulator for its unregistered offering of EOS tokens. The Block.one administrative order specifically outlines that "the ERC-20 tokens were securities under the federal securities laws pursuant to [the Howey test] and its progeny."

Read the full article in Law360.

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