Crypto Quarterly

Digital Assets, Blockchain and Related Technologies Update

Q3 2024

ROPES & GRAY

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.

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ENFORCEMENT LANDSCAPE

1. SEC Changes Leadership

Goodbye, Gurbir. Hello, Sanjay. On October 2, 2024, the Securities and Exchange Commission ("SEC") announced that Gurbir S. Grewal would resign as Director of the Division of Enforcement. During his tenure, Grewal led a historically proactive period of enforcement over digital assets. As of October 11, 2024, Sanjay Wadhwa (the prior Enforcement Division Director) has stepped in as Acting Director. Sam Waldon (the prior Division's Chief Counsel) has stepped in as Acting Deputy Director.

- **What does this mean for the digital assets space?** Under Grewal's leadership, the SEC took an aggressive enforcement stance. During Grewal's tenure, the SEC brought over 2,400 enforcement matters, resulting in over $20 billion in disgorgement, prejudgment interest and civil penalties; over 340 industry bars against wrongdoers; over $1 billion in awards to whistleblowers; and the return of billions of dollars to investors. This aggressive enforcement was particularly pronounced in the digital assets space, where the SEC policed various cryptocurrencies and other digital assets by arguing they fell under the Securities Enforcement Act and Securities Exchange Act. *See e.g., Securities and Exchange Commissions v. Ripple Labs, et al.*, 1:20-cv-10832 (S.D.N.Y.).
    - For example, in a speech Grewal delivered earlier this year at the William & Mary Business Law Review's Third Annual Symposium, Grewal touted the Enforcement Division's work "[o]ver the last decade" to bring "well over 100 crypto-related actions involving unlawful activity across the crypto markets." Grewal explained that "[d]uring this same period, the SEC has spoken clearly and consistently about the applicability of the securities laws in the crypto space."
- **Will leadership under Wadhwa take a different path, or will his efforts embody Grewal's principals?** As the SEC's October 2 press release indicates, Wadhwa worked closely with Grewal during his tenure to execute the SEC's enforcement agenda and to further the agency's mission to protect investors. However, Wadhwa's leadership and approach toward digital assets remains to be seen.
- **Is Gensler next?** Some pundits and investors speculate that the election and administration change may bring more change to the SEC—specifically, for current SEC Chair Gary Gensler. Although SEC employees enjoy protections from arbitrary removal, former U.S. president and current Republican presidential nominee, Donald Trump has commented that he would fire Gensler on "Day 1" if elected. By contrast, Vice President Kamala Harris has not commented on Gensler's tenure. The implications of Gensler's departure from the agency, which was announced after the close of Q3, will be discussed in the next edition of the Crypto Quarterly. Check out our next edition for more updates on the SEC's enforcement regime under its new leadership.

2. Cross-Agency Collaboration—A New Unified Phase of Regulation?

The digital assets and blockchain industry has been characterized by "turf wars" between regulatory agencies and departments. Perhaps the digital assets industry is entering a new phase of cooperation between agencies, as evidenced by joint partnerships and proposed litigation meant to clarify which "watchdog" is responsible for crypto.

- **Regulators and consumer protection groups join forces, warning the public about "pig butchering" scams.** "Pig butchering" scams (where fraudsters convince victims to "invest" in financial scams using friendly or romantic dialogue) are nothing new. But the Commodity Futures Trading Commission ("CFTC") Office of Consumer Outreach and Education ("OCEO") hopes to provide new information to protect investors against this longstanding practice. In September, the OCEO announced a new partnership with the American Bankers Association Foundation, Secret Service, SEC, Internal Revenue Service, Department of Homeland Security, and others to develop and distribute informational materials and investor alerts to guide the public with clear guidance on how "pig butchering" scams work.
  - This inter-agency collaboration, particularly between the SEC and CFTC—who have long been in an uneasy stalemate when it comes to jurisdiction over digital asset regulations—may signal an increased willingness to collaborate between the United States' top digital asset regulators. However, it remains to be seen whether this collaborative spirit will extend to other, more complicated aspects of digital asset regulation and enforcement.
- **In parallel actions, SEC and DOJ charge founder of decentralized network with fraud.** On July 30, 2024, the SEC and the U.S. Attorney's Office for the Southern District of New York ("S.D.N.Y.") announced parallel civil and criminal actions against Los Angeles-based Nader Al-Naji, the founder of the BitClout blockchain protocol. The SEC and DOJ targeted Al-Naji for allegedly perpetrating a multi-million-dollar crypto asset scheme which defrauded investors of over $250 million. Both the SEC and DOJ have pointed to BitClout's decentralized nature as evidence of Al-Naji's scheme.
  - Al-Naji launched BitClout under the pseudonym "Diamondhands." Touted as "The First Crypto Social Network," BitClout was described as a "cross between a financial app and a social app." With the platform's native token (BitClout), users could purchase other users' coins to "invest" in their reputation. BitClout was portrayed as a completely decentralized system, with a decentralized finance protocol ("DeFi") leveraging the DeSo Blockchain.
  - However, according to both the SEC and the DOJ, this "decentralized" system allowed Al-Naji to raise over $250 million in Bitcoin, millions of which he spent on personal items. The SEC charged Al-Naji with violations of securities laws, alleging that he profited from the unregistered offer and sale of securities; meanwhile, the DOJ charged Al-Naji with wire fraud, alleging that from January 2021, he sold BitClout tokens to investors in exchange for Bitcoin, then sold the Bitcoin for money he transferred to bank accounts and brokerage accounts.
  - Interestingly, the SEC points to BitCloud's purportedly "decentralized" nature as evidence of Al-Naji's solicitation of the native token to further his scheme. Al-Naji allegedly told a "prospective investor" that "even ***being 'fake' decentralized generally confuses regulators*** and deters them from going after you. In the case of the SEC . . . when you break the mold of 'a company with money in a bank,' the case becomes riskier in terms of litigation, which ***makes it less likely some career public servant will make it their mission to take you down.***" Al-Naji even secured a legal opinion from a "prominent U.S. law firm that concluded that [BitCloud] sales were not likely to be deemed securities transactions under federal law."
- **SEC versus CFTC—will Congress finally settle the score?** On September 10, 2024, Congressman John Rose (R-TN) proposed a new bill that, if enacted, could streamline the enforcement of digital assets and settle the long-running regulatory "turf war" between the CFTC and the SEC.
  - If enacted, the "Bridging Regulation and Innovation for Digital Global and Electronic Digital Assets" ("BRIDGE Digital Assets") Act would create a Joint Advisory Committee co-managed by the CFTC and the SEC to advise both agencies on digital asset rules and regulations.
  - The bill seeks to address a common criticism from crypto proponents: that the current fragmented framework confuses market participants, as the two agencies enforce conflicting regulatory approaches. Existing government organizations under the U.S Department of the Treasury have declined this role. According to U.S. Secretary of the Treasury Janet Yellen in a hearing before the House Financial Services Committee, "[i]t's not the job of the Financial Stability Oversight Council to adjudicate" between the two.

3. Texas Court Dismisses Consensys Suit on Procedural Grounds

On September 19, 2024, Judge Reed O'Connor of the U.S. District Court for the Northern District of Texas dismissed Consensys' preemptive lawsuit against the SEC for its alleged abuse of authority, writing that Consensys' "claim lacks a ripe case or controversy."

We have previously reported on Consensys' suit against the SEC, trying to prevent the SEC from further investigation or enforcement action against Consensys

based on the premise that ETH is a security. According to the complaint, on April 10, 2024, the company received a Wells notice stating the SEC's intent to recommend an enforcement action against Consensys for violating federal securities laws. The SEC has since dropped its investigation into "Ethereum 2.0," instead focusing its efforts on an enforcement action regarding Consensys' MetaMask software in the Eastern District of New York ("E.D.N.Y.").

Judge O'Connor dismissed Consensys' lawsuit for procedural reasons, namely for:

- **Mootness.** The court held that Consensys' claims regarding its Ethereum ecosystem were moot, because the SEC dropped its "Ethereum 2.0" investigation.
- **Ripeness.** The court held that Consensys' claims against the SEC were not "ripe" for judicial review, because (1) the MetaMask claim presents a pure question of law; and (2) a Wells notice and an enforcement action do not constitute the SEC's final judgment against Consensys, such that it impacts the company's legal rights or obligations. Further, the court found that Consensys failed to show it would suffer hardship from withholding judicial review of its claim.

Following the decision, Consensys described the decision to "dismiss[its] lawsuit on procedural grounds without looking at the merits of [its] claims against the SEC" as unfortunate, but declared itself "resolved to keep fighting for the rights of blockchain developers in the U.S. as [the company] contest[s] the SEC's action in Brooklyn." All eyes will certainly be on the SEC's case against Consensys as it progresses in E.D.N.Y.

4. SEC Brings Enforcement Actions with Flood of Settlements

This quarter, the SEC brought fewer enforcement actions involving digital assets than in previous quarters. However, among those enforcement actions that it did bring, many include settled charges with wide-ranging implications for digital assets, including investment pools and custodians.

i. Digital Asset Custody Violations

- **SEC brings landmark crypto enforcement action under Custody Rule.** On September 3, 2024 the SEC issued a press release detailing settled charges against Galois Capital Management LLC ("Galois") for failing to ensure that certain digital assets held by its private fund client were maintained with a qualified custodian, as required by Rule 206(4)-2 of the Investment Advisers Act of 1940 (the "Custody Rule"). According to the SEC's Order, Galois purportedly held certain digital assets that "were offered and sold as securities" on trading platforms that were not qualified custodians, such as FTX Trading Ltd. ("FTX"). The Order states that roughly half of the fund's assets under management were lost in connection with the highly publicized FTX collapse. The Order also claims that Galois misled investors by representing that redemptions required at least five business days' notice, while permitting some investors to redeem their assets more quickly.

- **Custody Rule changes still in flux.** This action comes in the wake of the SEC's February 2023 proposed amendments to the Custody Rule, which—as currently written—would require registered investment advisers ("RIAs") to hold all "client assets," including crypto assets, with a qualified custodian—even if the assets are neither funds or securities. Ropes & Gray has previously analyzed these proposed changes (e.g., here and here). Interestingly, the SEC selected and charged this high-profile case under the Custody Rule, even though these proposed amendments—and their applicability to digital assets—are not set in stone. For example, when SEC Chair Gary Gensler spoke at the SEC's 2024 Conference on Emerging Trends in Asset Management, he stated that, "[b]ased on feedback" he has "asked staff to consider whether it would be appropriate to seek further comment, ***possibly, on a modified proposal***" to the Custody Rule (emphasis added).

- **Custody challenges for digital assets.** Given the variety of digital currencies and decentralized operation of digital wallets, qualified custodians do not necessarily exist for all digital assets. Ironically, the Department of Justice ("DOJ") has faced its own challenges with custody of digital assets. *See* "Coinbase Prime to manage funds seized by DOJ," below. Therefore, this begs the question: Is compliance with the custody rule even possible for numerous digital asset investments?

ii. Unregistered offers and sales of digital asset securities

- **Abra is charged with the unregistered offer and sale of crypto assets.** On August 26, 2024, the SEC filed and settled charges against Plutus Lending LLC d/b/a Abra ("Abra") which were originally filed in the U.S. District Court for the District of Columbia ("D.D.C"). The complaint alleged Abra engaged in the unregistered offer and sale of its crypto asset lending product, Abra Earn, in or around July 2020 to U.S. investors. Abra had marketed Abra Earn as a method for U.S. investors to earn interest on their crypto assets, as Abra would deploy those assets to generate returns for itself and investors. The complaint alleges that Abra, at one time, had nearly $600 million in assets under management with $500 million sourced from U.S. investors. The complaint separately alleges that Abra operated as an unregistered investment company because of the alleged sale of crypto assets, given that it held more than 40 percent of its total assets, excluding cash, in investment securities. In any event, in June 2023, Abra Earn began winding down, instructing its U.S. based customers to withdraw their assets, which suggests that Abra understood that an enforcement action was imminent. Indeed, Abra has consented to an injunction

prohibiting further securities law violations and requiring it to pay civil penalties, though Abra did not admit the allegations as part of the settlement.

- **eToro settles and ceases trading activity.** On September 12, 2024, the SEC announced eToro USA LLC agreed to pay a $1.5-million civil penalty to settle charges against it. The SEC found that eToro operated as an unregistered broker and clearing agency by allowing U.S. customers to trade crypto assets, which it offered and sold as securities, through its online trading platform. In accordance with the SEC's order, eToro informed its investors that the only crypto assets U.S. customers will be able to trade on its platform will be Bitcoin, Bitcoin Cash, and Ether. In addition to the civil penalty, eToro agreed "within 187 days of the order, to liquidate any crypto assets being offered and sold as securities that eToro is unable to transfer to its customers, and return the proceeds to [those] customers."

- **Mango Markets settles for under a million.** On September 27, 2024, the SEC filed and settled charges against Mango DAO, a decentralized autonomous organization ("Mango DAO") and Blockworks Foundation, a Panama-based entity ("Blockworks"), brought in S.D.N.Y. which alleged the entities engaged in the unregistered offer and sale of "MNGO" tokens—the governance token of the Mango Markets platform. Indeed, the SEC's complaint alleges that they raised over $70 million from investors through the unregistered offer and sale of MNGO tokens. The complaint further alleges that since at least August 2021, Blockworks and Mango Labs LLC operated as unregistered brokers by recruiting users to trade securities through Mango Markets, advising users about the merits of securities investments, and assisting users with securities transactions on the Mango Markets platform. Mango DAO, Mango Labs, and Blockworks agreed to orders which required, among other conditions, the payment of about $700,000 in civil penalties.

iii. Digital Asset Fraud; Misrepresentations

- **Prager Metis settles negligence allegations in connection with FTX Audits.** On September 17, 2024, the SEC announced that two accounting firms, Prager Metis CPAs LLC and Prager Metis CPAs LLP (collectively "PMCPA"), agreed to settle charges related to their mishandling of their audits of FTX, among other auditor violations. One complaint, filed in S.D.N.Y., alleged that PMCPA issued reports which misrepresented that its audits complied with Generally Accepted Auditing Standards (GAAS), even though the SEC identified multiple instances where PMCPA failed to follow GAAS. In this complaint, the SEC also charged PMCPA with fraud, in respect to which PMCPA agreed to a permanent injunction, the payment of a $745,000 civil penalty, and other remedial measures. Another complaint, filed in the U.S. District Court for the Southern District of Florida, alleged that, between approximately December 2017 and October 2020, PMCPA "improperly included indemnification provisions in engagement letters for more than 200 audits, reviews, and exams and, as a result, were not independent from their clients, as required under the federal securities laws." In respect to these claims, PMCPA agreed to a permanent injunction, civil penalties of $1 million, and a $205,000 payment to capture combined disgorgement with prejudgment interest.

- **The SEC shuts down Rari Capital's digital asset investment pools.** On September 18, 2024, the SEC announced that it settled charges against Rari Capital, Inc. ("Rari") and its co-founders, which were originally filed in the U.S. District Court for the Central District of California ("C.D. Cal."). The charges allege that Rari and its co-founders "[misled] investors and [engaged] in unregistered broker activity in connection with two blockchain-based investment platforms[.]" The SEC alleges that Rari "offered two products, Earn pools and Fuse pools, which functioned like crypto asset investment funds," where customers could earn interest and governance tokens called "RGTs." The SEC alleges that, in offering and selling pool-interests and RGTs, Rari engaged in unregistered offers and sales of securities. The SEC's charges also allege that Rari and its co-founders (1) "falsely told investors that the Earn pools would automatically and autonomously rebalance their crypto assets into the highest yield-generating opportunities available" even though this was often not the case, and (2) "misleadingly touted the high annual percentage yield that investors would earn, but they failed to account for various fees" causing many Earn pool investors to lose money. Rari and its co-founders consented to various forms of relief, including civil penalties and disgorgement with prejudgment interest.

- **The SEC says TrustToken and TrueCoin are not so trustworthy or true.** On September 24, 2024, the SEC announced that it settled charges against TrueCoin LLC ("TrueCoin") and TrustToken Inc. ("TrustToken") in the U.S. District Court for the Northern District of California. The complaint alleges that TrueCoin, as an issuer of TUSD, and TrustToken as the developer and operator of TrueFi, a lending protocol, engaged in the unregistered offer and sale of TUSD, which the SEC also alleges is an investment contract. It was further alleged that TrustToken and TrueCoin engaged in a false marketing campaign to characterize TUSD as safe and fully backed by the U.S. dollar or an equivalent, although many assets backing TUSD were invested in an offshore investment fund. TrustToken and TrueCoin consented to final judgments enjoining them from violating relevant securities laws, whereby they each paid $163,766 in civil penalties, and TrueCoin consented to pay $340,930 in disgorgement and $31,528 in prejudgment interest.

5. Major Wins for the CFTC

This quarter, the CFTC notched several major wins, including a number of multi-million dollar settlements and judgments against individuals and entities engaged in digital asset-related schemes. For example, the CFTC secured a historic multibillion dollar judgment against now-defunct digital asset exchange FTX and its associated digital asset trading outfit, Alameda Research. But these wins were not without internal pushback from some CFTC Commissioners, who have continued to criticize the CFTC's "regulation through enforcement" approach and have called for the CFTC to engage in notice-and-comment rulemaking in the digital asset space.

- **Historic settlement brings one chapter of FTX and Alameda saga to a close.** In prior editions, we have discussed the spectacular collapse of digital asset exchange juggernaut FTX and Alameda Research, its affiliated trading operation. Nearly two years after the crypto juggernaut's downfall and historic bankruptcy filing, on August 8, 2024, the CFTC reached a consent order with FTX and Alameda. In the order, FTX agreed to pay $8.7 billion in restitution and $4 billion in disgorgement—the largest total recovery in the CFTC's history. The order also includes injunctive relief against further violations of the Commodity Exchange Act.

- **CFTC secures multi-million dollar judgments, targeting crypto Ponzi schemes.** This past September, the CFTC obtained substantial judgments against two individuals and several entities for misleading investors with digital asset Ponzi schemes. On September 3, 2024, a federal judge in the Northern District of Illinois issued a $210 million judgment against Sam Ikkurty and a number of entities for running a "crypto hedge fund" and falsely representing that the fund had performed well historically—omitting the fact that the fund had plummeted nearly to zero in just a few months. On September 20, 2024, the CFTC obtained a $36 million judgment against William Koo Ichioka, who falsely promised investors "10% returns every 30 business days" in unspecified digital asset investments. Ichioka was ordered to return $31 million in ill-gotten gains and pay a further fine of $5 million. In a separate criminal proceeding, Ichioka was sentenced to 48 months in prison.

- **CFTC issues controversial settlement with Uniswap Labs.** Last quarter, we discussed the SEC's regulatory action against Uniswap Labs ("Uniswap"), a digital asset exchange. On September 4, 2024, the CFTC reached a settlement with Uniswap.
  - **Settlement details.** The CFTC found that Uniswap illegally offered leveraged retail commodity transactions in digital assets. Uniswap agreed to pay a fine of $175,000 and to cease any violations of the Commodity Exchange Act. As the CFTC noted, Uniswap's "substantial cooperation" with the CFTC was a factor in the CFTC's issuance of a reduced civil penalty.
  - **Notable dissents.** CFTC Commissioners Summer K. Mersinger and Caroline D. Pham issued dissenting statements criticizing the CFTC's "regulation through enforcement" strategy of issuing "sweeping statements about the broader industry that are not germane to the case at hand and legal theories that have not been tested in court" in the context of a settlement order. Mersinger and Pham urged the CFTC to instead issue notice and comment regulations. Commissioner Pham also criticized that the CFTC's action was a "misguided and rushed attempt to beat the SEC to the punch and claim jurisdiction" over digital assets.

6. DOJ Enforcement Updates

The DOJ continues to charge and prosecute digital asset cases involving fraud, money laundering, and other crimes. However, this quarter was far from business as usual at the DOJ; with massive million-dollar take-downs and landmark cases involving crypto investments, the DOJ is still very focused on illicit actors who exploit digital assets.

- **Crypto co-founder faces prison time for platform's lack of banking controls.** On July 8, 2024, Artur Schaback pled guilty to conspiracy to fail to maintain an effective anti-money laundering ("AML") program. Schaback was co-founder and chief technology officer ("CTO") of Paxful Inc. ("Paxful"), a virtual currency platform and Peer-to-Peer ("P2P") money transmitting business. Schaback pled guilty to charges that he allowed users to trade on Paxful without proper AML policies and procedures, which allowed money laundering and other crimes on the platform. For instance, Paxful (1) failed to enact know-your-customer ("KYC") policies (policies and procedures to ensure the company can form a reasonable belief that it knows the true identity its customers); (2) advertised itself to consumers as being free of KYC information gathering; (3) presented third parties with fake AML policies which Schaback knew had not been implemented or enforced by the company; and (4) failed to file suspicious activity reports ("SARs"), despite knowing about criminal activities on the platform. Schaback faces up to five years in prison, and must resign from Paxful's Board of Directors.

- **Lessons learned.** Paxful demonstrates the importance of AML controls for digital asset P2P platforms. P2P platforms enable direct transactions between users, often bypassing traditional financial institutions; although this affords customers convenience and privacy, they can also be exploited for money laundering purposes. According to Financial Crimes Enforcement Network, U.S. Treasury ("FinCEN"), DeFi exchanges that use P2P technology must comply with obligations that apply to money transmitters under the Bank Secrecy Act. Therefore, P2P platforms may face civil and criminal penalties for failure to establish proper controls.

- **Coinbase Prime to manage funds seized by DOJ.** For nearly a decade, the U.S. Marshals Service ("USMS"), has struggled with the tracking and management of cryptocurrency seized by the DOJ; Coinbase Prime may now provide the solution. On July 1, 2024, Coinbase announced that it was awarded a $32.5 million services contract by the USMS to manage and dispose of seized cryptocurrency. Now, Coinbase is not only the largest registered cryptocurrency exchange in the U.S.—its Coinbase Prime platform will also provide custody and trading services over "Class 1" (large cap) digital assets seized by the Asset Forfeiture Division of the DOJ. Note that Coinbase Prime is the institution-focused, prime brokerage arm of Coinbase Global (COIN), better known for its retail-investor crypto exchange. However, the DOJ is already making good use of its custodial services. Blockchain data provided by Arkham Intelligence shows that the U.S. government has already made several multi-billion dollar transfers of digital assets to Coinbase Prime, with tags showing they were related to DOJ forfeitures from the online black market, Silk Road.

- **Historic crypto theft and spending spree leads to $230 million take-down.** The DOJ, working with the FBI and IRS-CI, arrested and indicted two hackers for the alleged theft of $230 million in cryptocurrency from an unnamed Washington, D.C. victim. The charges allege that Miami-based Malone Lam (online pseudonyms "Anne Hathaway" and "$$$") and Los Angeles-based Jeandiel Serrano (online pseudonyms "VersaceGod" and "@SkidStar") stole over 4,100 Bitcoin from a single Genesis creditor and "laundered" the proceeds through cryptocurrency exchanges and mixing services. The indictment states the suspects "used the illegally obtained cryptocurrency to purchase international travel, service at nightclubs, numerous luxury automobiles, watches, jewelry, designer handbags, and to pay for rental homes in Los Angeles and Miami." This is one of the largest crypto heists in history.
  - This historic heist highlights the new technology available to modern-day crypto criminals. Cross-border, instantaneous transactions in the crypto context allow fraudsters to conceal the flow of digital assets using "peel chains," mixers, and tumblers to prevent law enforcement from tracing the funds, while virtual private networks ("VPNs") and pass-through wallets add anonymity to the criminals' spending activities. In fact, according to Chainalysis, over $100 billion have been sent from known illicit wallets to conversion services since 2019.
  - The good news? The transparency of blockchain can allow investigators to uncover illicit activity that may otherwise go undetected. Blockchain analysis can help law enforcement unravel increasingly sophisticated money laundering networks.

- **California DOJ settles with Robinhood over custody issues, choosing to treat digital assets as commodities rather than securities.** California Attorney General Rob Bonta announced a $3.9 million settlement with Robinhood Crypto, LLC ("Robinhood") for the platform's lack of transparency regarding trading and handling, and for preventing customers from withdrawing their digital assets. Specifically, the settlement referred to a policy Robinhood abandoned in 2022, which prevented customers from withdrawing their tokens unless they re-sold to Robinhood before exiting the platform.
  - Notably, this settlement marks the first public action by the California DOJ against a cryptocurrency company. This settlement indicates that the California DOJ treated the digital assets at issue as ***commodities***—not ***securities***; rather than invoke California securities laws under Corporations Code § 25000 *et seq*., the California DOJ found that Robinhood violated the California Commodities Law (CCL).
  - However, Robinhood may have jumped out of the commodities frying pan and into the securities fire. The company recently disclosed in public filings that its cryptocurrency platform received a "Wells Notice" from the SEC in Q2 2024, stating that "the SEC Staff has advised RHC that it made a 'preliminary determination' to recommend that the SEC file an enforcement action against RHC alleging violations of Sections 15(a) and 17A of the Exchange Act."

PRIVATE LITIGATION

1. Crypto Class Action Dismissed for Lack of Personal Jurisdiction

Colorado federal judge grants motion to dismiss for lack of personal jurisdiction. On September 10, 2024, Chief Judge Philip Brimmer for U.S. District Court for the District of Colorado granted a cryptocurrency application's motion to dismiss, ruling that the lawsuit lacked a strong enough connection to Colorado to justify a class action suit in that venue. The order suggests that class action plaintiffs may struggle to establish personal jurisdiction in the digital assets space.

- On June 3, 2023, the class action plaintiffs brought a negligence claim against Estonia-based Atomic Protocol Systems d/b/a Atomic Wallet, developer Evercode Labs, and three individual defendants (including Konstantin Gladyshev, Atomic Wallet's CEO and majority owner), for failing to properly secure the assets of Atomic Wallet users. According to the complaint, the company's failure to "implement reasonable safeguards against security vulnerabilities" allowed a North Korean hacking group to access over 5,500 wallets and steal over $100 million in funds. The plaintiffs alleged personal jurisdiction was proper in Colorado because one Colorado customer received advertisements for Atomic Wallet on Twitter, and downloaded the application in Colorado.

- In his decision, Judge Brimmer held that the plaintiffs did not sufficiently allege the defendants' minimum contacts in Colorado. Brimmer's order stated that each of the plaintiff's theories regarding personal jurisdiction failed. Specifically, the order found that:
  - **Marketing to forum residents failed to establish personal jurisdiction.** Simply put, while "advertisements for Atomic Wallet posted on Twitter, now known as X, were viewable in Colorado," that in and of itself "do[es] not establish that Atomic Wallet intentionally directed its internet advertising activity to Colorado." The court also highlighted that "the complaint contain[ed] no allegations that Atomic Wallet marketed its platform to Colorado citizens, in particular."
  - **Product features available to forum residents failed to establish personal jurisdiction.** Plaintiffs argued that "security updates, mnemonic keys, desktop and mobile applications available to Colorado users" and "cash back tokens [sent] to Colorado users" demonstrate that Atomic Wallet directed activities into Colorado. But the court rejected this theory, because software applications like crypto wallets "can reach users without [a company] knowing where those users are located."
  - **Communication with forum residents failed to establish personal jurisdiction.** Plaintiff argued that Atomic Wallet's "communicat[ion] with users" established a connection to the forum state, because it demonstrated that it knew its customers were "located in Colorado." The court held that this is simply irrelevant, because "a defendant's knowledge of a plaintiff's connection to a forum state" is insufficient to establish purposeful availment.
- This order suggests that class action plaintiffs' personal jurisdiction challenges may be particularly pronounced for transnational companies, like Atomic Wallet, that lack a physical presence in the United States, let alone the forum state. Further, the perceived benefits of digital assets and blockchain products—such as anonymity and decentralization—may compound this challenge.

2. Rough Waters on the OpenSea?

On August 28, 2024, Ozone Networks, Inc., d/b/a OpenSea boldly publicized that it "recently received a Wells notice" from the SEC, alleging that non-fungible tokens ("NFTs") on its platform are unregistered securities. Wells notice recipients typically have at least 30 days to respond, so an enforcement action may soon follow. However, OpenSea's bold disclosure may have invited private litigants to seek damages premised on similar securities law theories. These would not be the first NFT-based class action securities claims; however, given the size and scope of OpenSea as a marketplace, cases against OpenSea may have an outsized impact on the legal analysis of NFTs.

- On September 19, 2024, plaintiffs filed a class action complaint against OpenSea in the Southern District of Florida, claiming that the website misled investors. The complaint alleges violations of New York and Florida laws prohibiting deceptive and unfair business practices, breach of warranty, and unjust enrichment.
- The crux of plaintiffs' complaint is that the NFTs exchanged on OpenSea are unregistered securities. In support, the complaint highlights several recent developments in digital asset litigation, including several cases litigated by the SEC involving cryptocurrencies (e.g., *SEC v. Terraform Labs Pte, Ltd., et al.*, No 1:23-cv-01346-JSR (S.D.N.Y. July 31, 2023), *SEC v. Ripple Labs, Inc., et al.*, No. 1:20-cv-10832 (S.D.N.Y. July 13, 2023) and cases settled by the SEC involving NFTS (e.g., Impact Theory and Stoner Cats matters).
- Founded in 2017, OpenSea is a crypto collectible marketplace that offers users the opportunity to create, buy, and sell NFTs. With more than three million active users and a trading volume of about $4.5 million per day as of January 2024, OpenSea is the largest P2P NFT trading platform in the world.
- Given OpenSea's market size and the novel theories at issue, this case—and others like it—will likely define the analysis of NFTs as securities. For example, the SEC brought previous NFT-as-securities cases against NFT creators, and analyzed the NFTs' characteristics under *Howey;* here, *OpenSea* plaintiffs bring a class action case against the marketplace, and the complaint paints the alleged "securities" with a broad brush, simply analyzing them all as "OpenSea NFTs." One attorney representing plaintiffs stated they "want to use this litigation to help create the framework of NFTs moving forward."

3. Motion To Dismiss Ends Crypto Mining Case—For Now

- **Motion to dismiss granted, ending securities class action case against crypto mining company.** On September 27, 2024, Judge Jamel K. Semper of the U.S. District Court for the District of New Jersey dismissed a proposed securities class action without prejudice, brought by investors who claimed a Bitcoin mining operator had violated the Securities Act and the Securities Exchange Act.
  - Class action plaintiffs brought the case against Iris Energy (now "IREN"), a New Jersey-based data center and Bitcoin mining company, after IREN issued an initial public offering ("IPO") in 2021 at $28 per share. According to the complaint, IREN violated securities laws by submitting offering documents, press releases, and 6-K documents with untrue statements of material fact or misleading omissions of fact. For example, class action plaintiffs claimed that IREN failed to disclose that its Bitcoin miners were owned through Non-Recourse Special Purpose Vehicles ("SPVs") financed by third-party lenders, which exposed the company to more risk.

- Defendants filed a motion to dismiss on August 4, 2023, arguing that class action plaintiffs "failed to identify anything misleading about the relevant disclosures" in the company's Prospectus and Registration Statement (collectively, the "Offering Documents"), and that the company had no duty to disclose more than what it already had. For example, with respect to the SPVs, Defendants argued that IREN's "Offering Documents expressly stated that 'We'—as in, for example, '[we have ownership of our electrical infrastructure and data centers'—means [IREN] and its consolidated subsidiaries, which included the wholly owned SPVs that (directly) owned the mining equipment." Defendants also argued plaintiffs had "not met their burden of pleading that Iris's reported goodwill was an actionable statement of opinion" that was subjectively disbelieved by the speaker.
- Judge Semper found both arguments convincing. Further, Judge Semper found that several alleged misstatements were protected by the Private Securities Litigation Reform Act (PSLRA) because they had "extensive and specific" meaningful cautionary language. The motion to dismiss was granted without prejudice.

LEGISLATION

This quarter did not see the passage of significant digital asset legislation; however, there were two noteworthy developments.

- **Update on Financial Innovation and Technology for the 21st Century Act, H.R.4763 ("FIT21").** As discussed in the previous edition of the Crypto Quarterly, on May 22, 2024, the U.S. House of Representatives passed FIT21, which would resolve SEC's and CFTC's jurisdictional battle over digital assets. In particular, it would delegate authority over *digital commodities* (assets which are relatively decentralized) to the CFTC and *restricted digital assets* (those which are sufficiently centralized to be securities) to the SEC. As of September 9, 2024, FIT21 has been referred to the Senate Committee on Banking, Housing, and Urban Affairs for further deliberation. Several Congressional lawmakers, including Rep. Patrick McHenry (R-NC) and Sen. Cynthia Lummis (R-WY), have suggested that FIT21 could be enacted into law before the end of 2024, possibly during the lame-duck session.

- **Senator Proposes Establishing Bitcoin Reserve.** On July 31, 2024, Sen. Cynthia Lummis (R-WY) introduced the Boosting Innovation, Technology and Competitiveness through Optimized Investment Nationwide (BITCOIN) Act in the U.S. Senate. The BITCOIN Act would create a decentralized network of secure Bitcoin vaults, for which the Act would "implement a 1-million-unit Bitcoin purchase program . . . to acquire a total stake of approximately 5% of total Bitcoin supply, mirroring the size and scope of gold reserves held by the United States." Many investors believe that the creation of such a strategic reserve would be a strong indicator of Bitcoin's long-term value.

- **New Hampsire Creates Framework for Decentralized Autonomous Organizations ("DAOs").** On July 30, 2024, New Hampshire enacted a framework for the regulation of DAOs, granting them rights which are typically afforded to other corporate entities.[1] Uniquely, the framework requires the DAO to satisfy a number of requirements to maintain its legal status, such as: being deployed on a permissionless blockchain, maintaining a unique address for the public to monitor the DAO, and having a decentralized governance system. In return, the framework affords participants and administrators with limited liability protections, noting that, "No participant, administrator, or legal representative of a New Hampshire DAO shall be obligated personally for any such debt, obligation, or liability of the New Hampshire DAO solely by reason of being a participant or acting as an administrator or legal representative of the New Hampshire DAO." If the DAO encounters a bug or exploit which renders it non-operational, this liability shield is maintained for all participants, administrators, and legal representatives unless they acted in gross negligence or bad faith. This bill suggests that New Hampshire is attempting to establish itself as a frontier for emerging technologies.

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:

The outcome of the 2024 election may have an outsized impact on the crypto industry, as evidenced by the money and support that industry leaders have poured into this year's election cycle. Some sources have reported that cryptocurrency super PACs have spent over $135 million on pro-crypto congressional races, while individuals with crypto special interests have spent millions to help return Donald Trump to the White House. The impact of the election and the incoming administration will be discussed in further detail in the next edition of the Crypto Quarterly.

[1] It establishes that DAOs may: sue and be sued, served with legal process, and consent to the jurisdiction of courts or arbitral tribunals within the state. The Act requires New Hampshire DAOs to maintain a registered office and registered agent within the state.