



## 15th Annual Securities Litigation and Regulatory Enforcement Update

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### State of the Cryptocurrency Market

On October 11, 2022, Skadden held the first program, “State of the Cryptocurrency Market,” in our 15th Annual Securities Litigation and Regulatory Enforcement Update series. The panelists for this presentation were **Alex Drylewski** and **Daniel Michael**, co-chairs of Skadden’s Web3 and Digital Assets Group; **Lara Flath**, New York-based Complex Litigation and Trials partner; **Peter Morrison**, leader of Skadden’s Los Angeles Litigation Group, co-head of the West Coast litigation practice and a member of the Web3 and Digital Assets Group; and Jake Chervinsky, head of policy at the Blockchain Association.

The webinar focused on a number of developments in securities litigation within the cryptocurrency market during the first nine months of 2022. The panelists discussed (i) securities-related filing trends, (ii) activity and enforcement by the Securities and Exchange Commission (SEC), (iii) recent developments in civil securities litigation and (iv) policy updates.

Below are high-level takeaways on each topic.

#### Securities-Related Filing Trends

First, panelists looked at the increase in crypto-related class action filings in the first half of 2022 as compared to 2021. While filings have steadily increased as cryptoasset offerings have expanded, the focus of these filings has shifted over the years. According to recent reports, from 2016 to 2020, 73% of crypto-related class action filings included allegations relating to initial coin offerings (ICOs). Over the last two years, however, a much smaller percentage of such filings have related to ICOs. Also, from 2016 to 2019, only 8% of crypto-related class action filings included allegations relating to exchanges. Since then, that number has increased substantially, up to 44% of filings between 2020 and 2022.

Panelists also reviewed recent enforcement trends: The SEC continues to be one of the main regulators engaged in the cryptocurrency space. From 2013 to 2021, the SEC brought a total of 97 enforcement actions involving cryptocurrency activity. In 2021 alone, the SEC brought a total of 20 enforcement actions. The majority of SEC cases to date have focused on two allegations: an unregistered offering of securities or fraud in the offer or sale of securities.

#### SEC Activity and Enforcement

Next, the panelists detailed how the SEC’s activity over 2022 has started to reflect Chair Gary Gensler’s attention to and priorities within the digital asset space. The

# Key Takeaways

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SEC has nearly doubled the size of its Crypto Assets and Cyber Unit, with six dedicated trial counsel and an expanded leadership team, including a new permanent chief and deputy chief. Possibly as a driver of this increased commitment, recently we have seen many more actions involving digital assets litigation rather than settlements as compared to the general trend across all SEC enforcement actions.

In addition, groups within the Division of Enforcement beyond the Crypto Asset and Cyber Unit remain active in the digital asset space. And, elsewhere within the SEC, the Division of Corporation Finance created an Office of Crypto Assets within its Disclosure Review Program.

In terms of market players in the digital asset space, the SEC recently increased its focus on market intermediaries, such as exchanges and broker-dealers, rather than issuers or promoters of single tokens. Cases against the latter group generally appear to be pursued only where there are allegations of fraud and substantial investor losses.

The SEC has also demonstrated an interest in two relatively new areas of digital asset enforcement: insider trading and registration violations. As an insider trading example, in *SEC v. Wahi*, No. 22 Civ. 1009 (W.D. Wash. July 21, 2022), the agency alleged a scheme by a former Coinbase product manager, his brother and a friend to trade in digital assets ahead of announcements that Coinbase would be listing them. Although the SEC alleged that nine of the digital assets involved were securities, the Department of Justice indictment alleged insider trading in 25 digital assets. Of the nine the SEC deemed to be securities, there was no clear-cut line as to the factors that led to that decision. For example, seven of the assets used proceeds to fund the project, four reserved a significant portion for founders and four allowed purchasers to receive a portion of revenues.

Regarding registration violations, two recent cases exhibit the broader view the SEC is applying to this issue, showing the agency's willingness to charge individuals and entities beyond the issuer for direct violations of the registration provisions. In *SEC v. Okhotnikov*, No. 22 Civ. 3978 (N.D. Ill. Aug. 1, 2022), the SEC charged 11 individual defendants with registration violations, including four people located abroad, three domestic promoters and four members of a group that promoted the digital asset. The complaint alleges that each defendant was a necessary participant or substantial factor in failure to register. Similarly, in *SEC v. Ian Balina*, No. 22 Civ. 950 (W.D. Tex. Sept. 19, 2022), the SEC charged a cryptocurrency "influencer" who promoted tokens while simultaneously purchasing a significant portion of those tokens and organizing an "investing pool" of approximately 50 individuals.

### Recent Developments in Civil Securities Litigation

#### Developments Involving *Morrison v. Nat'l Australia Bank*, 561 U.S. 247 (2010)

Presenters then discussed the notable difficulty that plaintiffs in 2022 have faced in alleging securities claims sufficient to satisfy the test set forth in *Morrison v. Nat'l Australia Bank*, 561 U.S. 247 (2010), which addresses the impermissible extraterritorial application of the federal securities laws. This issue is frequently relevant due to the borderless nature of the digital assets industry. Two recent cases demonstrate this trend.

In *Anderson v. Binance*, No. 1:20-CV-2803 (ALC) (S.D.N.Y.), the plaintiffs alleged claims under the Securities Act, the Exchange Act and over 20 state Blue Sky laws against Binance in connection with the sale of certain digital tokens on the Binance platform. Judge Andrew Carter granted Binance's motion to dismiss. One basis for the court's dismissal was *Morrison*. The court held that the presence of third-party servers in California was insufficient to establish that Binance was a domestic exchange or that the transactions were domestic. Judge Carter similarly held that the presence of some employees in California and job postings outside the United States were insufficient.

In *Williams v. Block.one*, No. 1:20-cv-03829-LAK (S.D.N.Y.), the plaintiffs alleged federal securities claims against defendants in connection with Block.one's ICO. The parties reached a \$27.5 million settlement. However, the court rejected the settlement, concluding that the plaintiff had failed to take into account whether the federal securities laws applied under *Morrison* to each individual class member's token purchases.

#### Additional Developments

Panelists highlighted two other cases. First, in *Audet v. Fraser*, No. 3:16-cv-940 (MPS)(D. Conn.), for the first time, a jury considered whether digital assets were securities under the *Howey* test and found that none of the assets were securities. On post-trial review, Judge Michael Shea upheld the jury's findings on three of the four assets at issue. With respect to an asset called "Hashlets," which allegedly represented shares in profits from the issuing company's computing power, Judge Shea concluded that the jury's verdict (*i.e.*, that Hashlets were not securities) was not against the weight of the evidence — due to a lack of a common enterprise or an expectation of profits based on the efforts of other. Notably, this asset was included in the SEC's earlier complaint against GAW and its founder. Specifically, Judge Shea emphasized that Hashlet owners "could receive 'very different payouts,'" undercutting horizontal commonality, and that they exercised "significant investor control" through their selection of mining pools, which undercut any expectation of profits from

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the efforts of others. As of October 7, 2022, the parties indicated to the court that they have reached a settlement (rather than proceeding to trial on the one remaining asset).

Second, presenters discussed how *Robertson v. Cuban, et al.*, No. 22-cv-22538 (S.D. Fla.), illustrates several emerging trends in cryptocurrency securities cases — most notably, plaintiffs naming well-known promoters or celebrities in lawsuits. *Robertson* involves the Voyager platform, which allowed users to trade digital assets via a mobile application. In October 2021, Voyager partnered with the Dallas Mavericks. In December 2021, a putative class action was filed against Voyager alleging fraud, unfair trade practices and unjust enrichment under Florida state law, and in January 2022, the SEC launched an investigation into Voyager. By July 2022, Voyager filed for bankruptcy, and the class action was stayed. In August 2022, the same counsel brought another class action and included Mark Cuban, the Dallas Mavericks and the CEO of Voyager as defendants, alleging violations of state consumer protection/unfair competition and securities laws. While the CEO of Voyager has since been voluntarily dismissed from the case, the inclusion of Mr. Cuban was notable. The case accuses him of making false and misleading statements about Voyager's commissions, its level of risk and its interest rates.

### Policy Updates

Lastly, Jake Chervinsky, the head of policy at the Blockchain Association, provided updates on the status of various blockchain and cryptocurrency policy initiatives in Washington, D.C. He explained that the industry views the securities laws as its top issue, with most participants viewing regulation as “existential.” While the industry is hopeful that pro-development ideas such as Commissioner Hester Peirce’s safe harbor concept will take hold, signs suggest there will be no progress on that front from the SEC.

Mr. Chervinsky concluded by highlighting the two main policy areas of focus at this moment. First, proposed rules that expand the definition of “dealer” and “exchange” to potentially include aspects of the cryptocurrency market are getting a lot of attention. Second, three primary legislative proposals, if accepted, would determine what agency will regulate aspects of the cryptocurrency market going forward.