

SEC Actions Show Tough Crypto Stance So Far This Year

By **Adam Aderton, Elizabeth Gray and Kristina Littman** (June 2, 2023)

Through the first half of 2023, the U.S. Securities and Exchange Commission has continued its vigorous approach to enforcement, pursuing novel theories and imposing enhanced remedies.

The commission has been particularly zealous with respect to all things crypto. The SEC has asserted jurisdiction over crypto exchanges,[1] lending platforms[2] and other intermediaries, both by charging exchanges for failing to register with the commission and by enforcing the more traditional anti-fraud and anti-manipulation provisions of the Securities Exchange Act.



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A Heightened Focus on Crypto Lenders and Intermediaries

Crypto was a top priority for SEC enforcement in the first half of 2023, resulting in a flurry of activity following the collapse of FTX Trading Ltd. in November 2022.

The SEC has focused on crypto asset exchanges and their operators. For example, the commission charged crypto asset exchange platform Beaxy.com and its founder Artak Hamazaspian with the unregistered offering of securities arising out of the platform's offer of Beaxy token, or BXY.[3]



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Windy Inc., the entity that came to operate and maintain the Beaxy platform following Hamazaspian's separation, and its executives were also the subjects of numerous charges, including operating an unregistered national exchange, clearing agency and broker-dealer.[4]

Interestingly, a market maker who coordinated with Beaxy's operators to maintain liquidity of BXY was also charged with operating as an unregistered broker-dealer.[5]



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By charging a market maker operating within an unregistered exchange, the commission may be signaling a greater intent to prosecute not only exchanges, but also sophisticated entities that make markets or facilitate trading in crypto asset securities.

The commission has also charged offshore entities and individuals that are alleged to have interacted with U.S. investors and markets. On April 17, the SEC brought charges against U.S.-based crypto asset trading platform Bittrex Inc. and Bittrex Global.[6]

Just over two weeks earlier, Bittrex cofounder Richie Lai announced via Twitter that Bittrex would begin winding down U.S. operations by April 30, citing, among other causes, unclear regulatory requirements.[7]

In charging Bittrex after the termination of trading and mere days before the company's planned withdrawal from the U.S., the commission sent a clear message that it is prioritizing enforcement actions against crypto intermediaries.[8]

Extending Traditional Theories of Fraud and Manipulation to Cryptocurrency

Beyond registration violations, the SEC also continued to bring actions against crypto executives and companies under traditional fraud and manipulation theories.

The commission's headline-grabbing charges against four executives of FTX, once the world's third-largest crypto exchange by trading volume, and its sister crypto hedge fund, Alameda Research LLC, is the most prominent example.

While the SEC has yet to charge FTX itself, it has alleged that four executives of FTX or Alameda violated certain anti-fraud provisions by deceiving FTX's investors when they touted FTX as a safe crypto asset trading platform.

Instead, the SEC alleges that FTX diverted customer funds to Alameda for the hedge fund's own trading purposes, paid Alameda's lenders and bankrolled FTX CEO Sam Bankman-Fried's personal investments.

Three of the executives — Gary Wang, Caroline Ellison and Nishad Singh — settled with the commission, agreeing to, among other things, prohibitions on their participation in the issuance, purchase, offer or sale of any securities, except for trading in their own personal accounts.[9]

The commission's civil action against Bankman-Fried has been stayed pending resolution of a parallel criminal case filed by the U.S. Attorney's Office for the Southern District of New York.[10]

The commission filed a similar complaint against Singapore-based blockchain firm and stablecoin operator, Terraform Labs PTE Ltd., and its CEO, Do Hyeong Kwon, in February.[11]

The SEC alleges that Terraform offered and sold unregistered crypto asset securities, LUNA and UST, to U.S.-based investors and that both Terraform and Kwon lied when promoting these securities, including by touting their profit potential and stability, despite clear flaws in Terraform's protocols and blockchain.[12]

While Terraform's collapse was one of the first big failures at the start of the crypto winter, the commission's case against the stablecoin operator is based on novel legal theories that distinguish it from many of the commission's other cases. Kwon and his attorneys have asserted that the commission's complaint is unfounded because LUNA and UST are currencies, not securities.[13]

The SEC alleges, however, that UST is in fact a security because it could be exchanged for LUNA and is therefore a receipt or what's known as a right to subscribe or purchase, as articulated in Section 2(a)(1) of the Securities Act.[14]

Likewise, the commission asserts that LUNA, UST and other stablecoins within the Terraform ecosystem[15] are investment contracts, as delineated in the U.S. Supreme Court's 1946 decision in SEC v. W.J. Howey Co., and therefore constitute securities subject to commission jurisdiction.[16]

The SEC appears to assert an alternate theory to establish that UST is a security, alleging that it meets the Howey test because investors could deposit their UST into a smart contract

associated with the Anchor Protocol, which advertised a 20% return.

Rather than alleging that the Anchor Protocol is a security akin to the crypto lending actions the SEC has instituted, the SEC seems to argue that because UST could be invested in a profit-bearing opportunity, the UST itself is a security.[17]

The SEC has also brought cases alleging manipulation in the crypto markets. In January, the commission charged Avraham Eisenberg with securities fraud and market manipulation under the Exchange Act for coordinating an attack on the crypto asset trading platform, Mango Markets.[18]

According to the commission's complaint, Eisenberg manipulated the MNGO token, which the commission alleges is an investment contract security,[19] by engaging in a series of large purchases of thinly traded MNGO tokens to artificially raise the price of MNGO tokens and then withdrawing over \$110 million worth of various crypto assets from Mango Markets.[20]

While the commission has not charged Mango Markets with any securities law violations, the complaint against Eisenberg states that "MNGO Token's 'Governance' Rights Are Illusory," noting that the "'governance' afforded to MNGO token holders was limited and minimal." [21]

This could be a shot across the bow at decentralized finance and decentralized autonomous organizations like Mango Markets that have no official governing body.

In yet another litigated action in March, the commission charged Justin Sun and three of his wholly owned companies, Tron Foundation Limited, BitTorrent Foundation Ltd. and Rainberry Inc. — formerly BitTorrent Inc. — with fraud and market manipulation.[22]

As with the complaints against Terraform, Kwon and Eisenberg, the commission's complaint states that Tronix, known as TRX, and BitTorrent, known as BTT — the crypto assets offered and sold through Sun's companies — constitute investment contracts and therefore securities under Section 2(a)(1) of the Securities Act.[23]

The Sun complaint explicitly clarifies the commission's view that the token itself, rather than the initial offer or sale of the token, is the investment contract and therefore the token itself is a security.[24]

Beyond fraud and market manipulation, the commission also charged Sun with illegally orchestrating a scheme to pay celebrities to tout TRX and BTT without disclosing their compensation.[25]

Aggressive Touting Action

Section 17(b) of the Securities Act makes it unlawful for any person to promote a security without disclosing the receipt and amount of consideration the individual received from an issuer.

With the rise of crypto's popularity and its appeal to retail investors, the commission has also taken an aggressive approach to charging cases of illegal touting, bringing actions against well-known celebrities and social media influencers who publicized the offerings.

For example, when the SEC filed its complaint in March against Sun and his companies, the

commission simultaneously charged a number of celebrities who failed to disclose that they received payments from Sun and his companies to advertise TRX and BTT.

Those celebrities include actresses Lindsay Lohan and Michelle Mason, known as Kendra Lust, social media influencer Jake Paul, and musicians Soulja Boy, Austin Mahone, Lil Yachty, Ne-Yo and Akon.[26]

All except Soulja Boy and Austin Mahone settled the charges by agreeing to pay a total of \$400,000 in disgorgement, interest and penalties.[27]

The charges against Tron's promoters came one month after the commission charged NBA hall of famer Paul Pierce with making false or misleading statements about and illegally touting EMAX tokens, a crypto asset offered and sold on the EthereumMax website, without disclosing his compensation.[28]

Pierce settled his case, without admitting or denying the charges, and agreed to pay \$240,000 in disgorgement of profits, as well as \$1.1 million as a civil penalty.

The case against Pierce followed the more widely publicized charging of media mogul Kim Kardashian in October 2022 for touting EMAX.[29] Kardashian also agreed to disgorge her profits and pay a \$1 million civil penalty to settle the Commission's charges against her.[30]

The Landscape at the Moment, and What May Come Next

The commission has ramped up its litigation docket relating to crypto assets, bringing actions against crypto exchanges, lending platforms and issuers alike.

With these actions, the SEC reiterates a position it has maintained for some time, that crypto assets are securities and thus under its jurisdiction. The SEC has reinforced its position with innovative arguments and heftier penalties, which provides some insight into what may be to come.

While much remains to be seen as to whether courts will agree with the legal theories put forth by the SEC in bringing crypto assets within its purview, it is clear that the commission has no plans of letting up on its enforcement efforts.

Across the entities subject to SEC jurisdiction, many companies and individuals are willing to agree to — and the SEC appears likely to continue to pursue — costly settlements, while the list of litigated actions pending in federal courts across the country continues to increase.

As shown by the Beaxy action, the SEC may also increase the frequency of actions brought against individuals and entities that transact on crypto exchanges and lending platforms, such as market makers.

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[1] "Crypto exchanges" typically refer to businesses that provide their customers with a platform to buy, sell, swap, or otherwise trade crypto assets in exchange for other crypto assets or conventional fiat currencies.

[2] "Crypto lending platforms" typically refer to businesses that allow their customers to lend or borrow crypto assets in exchange for some kind of pecuniary gain, most typically as some form of interest payable in crypto assets or fiat currencies.

[3] SEC Press Release, "SEC Charges Crypto Trading Platform Beaxy and Its Executives for Operating an Unregistered Exchange, Broker, and Clearing Agency" (Apr. 3, 2023), <https://www.sec.gov/litigation/litreleases/2023/lr25687.htm>. Hamazsryan has also been charged with securities fraud related to both the offer and purchase or sale of securities. Complaint ¶¶ 142–52, SEC v. Beaxy Digital, Ltd., No. 1:23-cv-01962 (N.D. Ill. Mar. 29, 2023), Dkt. No. 1.

[4] *Id.* ¶¶ 156–66. Nicholas Murphy and Randolph Bay Abbott were charged in their capacity as control persons of Windy. *Id.* ¶¶ 162–66.

[5] *Id.* ¶¶ 167–69.

[6] SEC Press Release, "SEC Charges Crypto Asset Trading Platform Bittrex and its Former CEO for Operating an Unregistered Exchange, Broker, and Clearing Agency" (Apr. 17, 2023), <https://www.sec.gov/news/press-release/2023-78>.

[7] @richiela, TWITTER (Mar. 31, 2023, 3:06 p.m.) (tweet from Richie Lai announcing Bittrex's winding-down of U.S. activities), <https://twitter.com/richiela/status/1641879643497308161?cxt=HHwWgoDRqca1kMktAAAA>.

[8] Bittrex has since filed for bankruptcy. See Mengqi Sun & Becky Yerak, Bittrex Files for Bankruptcy After SEC Sues the Crypto Platform, THE WALL STREET JOURNAL (May 8, 2023), https://www.wsj.com/articles/crypto-platform-bittrex-files-for-bankruptcy-f4548b9c?mod=Searchresults_pos1&page=1.

[9] SEC Press Release, "SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX" (Dec. 13, 2022), <https://www.sec.gov/news/press-release/2022-219>; SEC Press Release, "SEC Charges Caroline Ellison and Gary Wang with Defrauding Investors in Crypto Asset Trading Platform Ftx" (Jan. 19, 2023), <https://www.sec.gov/news/press-release/2022-234>; SEC Press Release, "SEC Charges Nishad Singh with Defrauding Investors in Crypto Asset Trading Platform FTX" (Feb. 28, 2023), <https://www.sec.gov/news/press-release/2023-40>.

[10] Order on Notice of Motion to Intervene and Stay, S.E.C. v. Bankman-Fried, No. 22-cv-10501-PKC (S.D.N.Y. Feb. 13, 2023).

[11] SEC Press Release, "SEC Charges Terraform and CEO Do Kwon with Defrauding Investors in Crypto Schemes" (Feb. 16, 2023), <https://www.sec.gov/news/press-release/2023-32>.

[12] Id.

[13] Memorandum of Law in Support of Defendants' Motion to Dismiss the Amended Complaint, SEC v. Terraform Labs PTE Ltd., No. 1:23-cv-1346 (S.D.N.Y. Apr. 21, 2023), ECF No. 28.

[14] Terraform Complaint ¶ 84.

[15] In its complaint, the Commission also alleges that Terraform's mAssets, which were created through the Mirror Protocol and intended to "mirror" the price of stocks traded in traditional U.S. markets, constituted "security-based swaps" in violation of Section 5(e) of the Securities Act and Section 6(l) of the Exchange Act. Terraform Complaint ¶¶ 97–103. The SEC bases its allegation on the following facts: (1) the transactions were executed through an exchange of the investor's payment of collateral in exchange for the mAsset, (2) the financial risk associated with any future change in value of a security was transferred during the transaction, without also conveying any ownership interest in the underlying security, and (3) the transactions were effectuated through the Mirror Protocol with or for persons who were not eligible to participate in investment contracts. Id. ¶¶ 101–03.

[16] Id. ¶ 23.

[17] Id. ¶ 69–75.

[18] SEC Press Release, "SEC Charges Avraham Eisenberg with Manipulating Mango Markets' 'Governance Token' to Steal \$116 Million of Crypto Assets (Jan. 23, 2023), <https://www.sec.gov/news/press-release/2023-13>.

[19] Complaint ¶ 30, SEC v. Eisenberg, No. 1:23-cv-503 (S.D.N.Y. Jan. 20, 2023), ECF No. 1.

[20] Id. ¶ 3, 5.

[21] Id. ¶ 55.

[22] SEC Press Release, "SEC Charges Crypto Entrepreneur Justin Sun and his Companies for Fraud and Other Securities Law Violations" (March 22, 2023), <https://www.sec.gov/news/press-release/2023-59>.

[23] Complaint ¶ 20, SEC v. Sun, No. 23-cv-2433 (S.D.N.Y. Mar. 22, 2023), ECF No. 1.

[24] Id. ¶¶ 20, 47, 88.

[25] SEC Press Release, "SEC Charges Crypto Entrepreneur Justin Sun and his Companies for Fraud and Other Securities Law Violations" (March 22, 2023), <https://www.sec.gov/news/press-release/2023-59>.

[26] Id.

[27] Id.

[28] SEC Press Release, "SEC Charges NBA Hall of Famer Paul Pierce for Unlawfully Touting and Making Misleading Statements about Crypto Security" (Feb. 17, 2023), <https://www.sec.gov/news/press-release/2023-34>.

[29] SEC Press Release, "SEC Charges Kim Kardashian for Unlawfully Touting Crypto Security" (Oct. 3, 2022), <https://www.sec.gov/news/press-release/2022-183>; see also John Hyatt, The Untold Story Behind Emax, The Cryptocurrency Kim Kardashian Got Busted For Hying, *Forbes* (Nov. 11, 2022), <https://www.forbes.com/sites/johnhyatt/2022/11/11/the-untold-story-behind-emax-the-cryptocurrency-kim-kardashian-got-busted-for-hying/?sh=8340d1c40d7b>.

[30] SEC Press Release, "SEC Charges Kim Kardashian for Unlawfully Touting Crypto Security" (Oct. 3, 2022), <https://www.sec.gov/news/press-release/2022-183>.