Cryptocurrency Companies Should Expect More SEC Enforcement in the Near Future

Corporate News: A Legal Update

By Eric Fogel on March 28, 2023

The Securities and Exchange Commission (SEC) has been increasing its enforcement actions against cryptocurrency companies and individuals in recent years. In 2022, the SEC brought 24 litigation actions in federal courts and 6 administrative proceedings against cryptocurrency companies and individuals, a significant increase over the previous year.

During 2022, the SEC charged a total of 79 defendants or respondents in cryptocurrency cases, with 29% being firms and 71% individuals.

Nearly half of the 30 enforcement actions brought that year involved initial coin offerings, and over half of those included allegations of fraud. See *SEC v. Chiang, et al.*(SEC, Litigation Release No. 25377, April 28, 2022), where the SEC charged the defendants for their roles in raising over $10 million through two fraudulent and unregistered digital asset securities offerings. See also *SEC v. Block Bits Capital, LLC, et al.* (SEC, Litigation Release No. 25376, April 28, 2022), where the SEC charged Block Bits Capital, LLC and its co-founders with conducting a fraudulent unregistered securities offering.

Additionally, the SEC also brought a case for insider trading and market manipulation. In *SEC v. Wahi, et al.* (Case 2:22-cv-01009, July 21, 2022), the SEC brought insider trading charges against a former Coinbase product manager, his brother, and his friend for perpetrating a scheme to trade ahead of multiple announcements regarding certain crypto assets that would be made available for trading on the Coinbase platform.

Despite this increase, the number of cryptocurrency-related cases remains a relatively small fraction of the total enforcement actions that the SEC brings in any given year. Given its limited resources, the SEC has focused its efforts on key market intermediaries such as exchanges, lenders, decentralized finance platforms, stable coins, and larger cryptocurrency companies.

SEC Chair Gary Gensler has added more enforcement attorneys to the SEC's crypto unit and shifted the agency's litigation strategy from focusing on individual tokens to the trading platforms that sell cryptocurrencies to investors. His reasoning is there are more than 10,000 cryptocurrencies in existence, but only a handful of major platforms that cater to U.S. investors.

However, state securities departments are more active in prosecuting enforcement actions against individuals and their companies. The states of Texas, North Carolina, North Dakota, Colorado, and Alabama have been particularly active in this regard. State securities law departments can move quicker than the SEC to issue cease and desist letters and enforcement actions.

Most of these enforcement actions hinge on whether cryptocurrency investments or platforms and their derivatives are considered securities under the *Howey* test, as defined by the U.S. Supreme Court. *SEC v. W. J. Howey Co.,* 328 U.S. 293 (1946). Mr. Gensler is pushing to hold the cryptocurrency firms to the same rules that apply to stock and bonds, rather than write a raft of new regulations for the cryptocurrency sector.

Since 2018, the SEC has brought or settled more than 90 lawsuits related to cryptocurrencies. More than 30 have come during Mr. Gensler's time in office. The SEC chief has said the vast majority of cryptocurrencies are securities—like stocks and bonds—that should follow the agency's rigorous disclosure requirements before being sold to the investing public.

As for specific cases, in September 2022, the SEC charged Chicago Crypto Capital LLC, its owner, and former salesmen for allegedly defrauding investors during their unregistered offering of crypto asset securities. *SEC v. Chicago Crypto Capital LLC, et al.* (SEC, Litigation Release No. 25506, September 14, 2022). Also in September 2022, the SEC issued a cease-and-desist order against Sparkster, Ltd. and its CEO for the unregistered offer and sale of crypto asset securities from April 2018 through July 2018, and charged crypto influencer Ian Balina for failing to disclose compensation he received from Sparkster for publicly promoting its tokens, and for failing to file a registration statement with the SEC for Sparkster tokens that he resold. See *In re Sparkster, Ltd., et al.*

Moreover, the SEC has stepped up its warnings in the wake of FTX's collapse. Mr. Gensler said in an interview in December 2022 that the "runway is getting shorter" for exchanges to register with the SEC and adopt rules that stock exchanges such as the Nasdaq Stock Market must follow. "Enforcement is ready to stand up," David Hirsch, chief of the SEC enforcement division's crypto assets and cyber unit, said at a conference in December 2022, echoing the Chairman's comments a few days earlier.

In conclusion, participants in the cryptocurrency industry should plan now to make adjustments to their business models or seek registration under the securities laws or credible exemptions therefrom. Moreover, cryptocurrency exchanges and broker dealers should expect increased regulation in the near future as well.