

Review of 2021 Trends in SEC Crypto Enforcement Actions

SEC Chair Gary Gensler has consistently underscored that crypto assets are among the key capital market trends to which the SEC will devote its resources in 2022.¹ Despite the SEC's articulated focus on crypto assets, however, Chair Gensler has been recalcitrant with respect to detailing how the SEC's Division of Enforcement will approach crypto assets, technologies, and platforms, instead maintaining that "our laws are clear."² In response to market criticism of the Commission's "regulation by enforcement" approach,³ Chair Gensler has stated, "I just call it 'enforcement.'"⁴ Most others in the crypto space do not share this sentiment, however. Indeed, CFTC Commissioner Dawn Stump recently announced that:

As financial markets evolve and adapt to new demands, market regulators must not stifle beneficial innovations by clinging rigidly to regulatory approaches of the past that may no longer be fit for purpose. But by the same token, infrastructure providers who offer the market access to new, innovative services must not dismiss the fact that they may be required to seek and comply with regulatory oversight in order to assure market integrity and customer protection. It's time to thoughtfully consider the *hard things* we all must do to get comfortable with current realities.⁵

Similarly, Michael Liftik, Co-Chair of Quinn Emanuel's SEC Enforcement Practice, has described the crypto space as "crying out for clarity and further guidance from the staff or the Commission."⁶ The natural outcome of regulation by enforcement is that lawyers in the crypto space must spend hours "picking through the breadcrumbs of enforcement orders to try to figure out where the staff is."⁷

In this article, we review SEC crypto enforcement actions and statistics from 2021 in an attempt to discern some key takeaways from the breadcrumbs:

¹ SEC Chair Gary Gensler, "Testimony before the Subcommittee on Financial Services and General Government, U.S. House Appropriations Committee" (May 26, 2021), available at <https://www.sec.gov/news/testimony/gensler-2021-05-26> (highlighting crypto assets as one of five key capital market trends affecting agency's resource needs; see also FY 2022 Congressional Budget Justification Annual Performance Plan, available at https://www.sec.gov/files/FY%202022%20Congressional%20Budget%20Justification%20Annual%20Performance%20Plan_FINAL.pdf (citing "the growth and volatility of crypto assets" as a cause of the need for additional agency resources).

² SEC Chair Gary Gensler, "Keynote Remarks," Securities Enforcement Forum 2021 (Nov. 4, 2021), available at <https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104>.

³ Nicholas Pongratz, "Crypto Regulation 'Enforcement' Addressed During Gensler Speech" (Nov. 2021), available at <https://beincrypto.com/crypto-regulation-enforcement-addressed-during-gensler-speech/>.

⁴ *Id.*

⁵ Commissioner Dawn Stump, "We Can Do Hard Things," Remarks at Chamber of Digital Commerce (Jan. 13, 2022), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opastump11> (emphasis in original).

⁶ Chris Matthews, "SEC cyber chief warns the agency is 'very focused' on policing crypto exchanges" (Nov. 5, 2021), available at <https://www.marketwatch.com/story/sec-cyber-chief-warns-the-agency-is-very-focused-on-policing-crypto-exchanges-11636069012> (quoting Quinn Emanuel Partner, Michael Liftik).

⁷ *Id.*

- The number of crypto enforcement actions brought in 2021 largely tracks those brought in 2020, only slowing down in Q2 2021;⁸
- The number of crypto enforcement actions in 2021 that alleged fraud decreased from 2020;⁹
- The number of crypto enforcement actions brought against individuals for offering securities in unregistered transactions is increasing; and
- The split between disgorgement and civil penalties appears to be shifting, following the U.S. Supreme Court’s decision in *Liu*,¹⁰ but disgorgement awards remained significant in at least one crypto asset case.

I. Looking Back: Recap of 2021 Crypto Asset Enforcement

In 2020, a total of 26 cryptocurrency enforcement actions were brought by the SEC, broken out as follows: (i) Q1–7 actions; (ii) Q2–7 actions; (iii) Q3–8 actions; and (iv) Q4–4 actions.¹¹ In 2021, the SEC brought a total of 21 cryptocurrency enforcement actions (a decrease of 19%), as follows: (i) Q1–6 actions; (ii) Q2–4 actions; (iii) Q3–9 actions; (iv) Q4–2 actions.¹²

The Percentage of Crypto Enforcement Actions in 2021 Alleging Fraud Is Consistent With 2020

In 2020, 16 of the 26 cryptocurrency enforcement actions (61.5%) included an allegation of fraud. In 2021, 13 of the 21 cryptocurrency enforcement actions (61.9%) included an allegation of fraud.

The consistent percentage of SEC cryptocurrency enforcement actions involving fraud across years evidences that, under Chair Gensler, the SEC is continuing to focus its enforcement resources first on cases that involve fraud. In 2022, we would expect this focus on fraud to continue, but that the types of cases filed will likely continue to shift away from frauds in connections with initial coin offerings, toward retail and consumer scams that involve crypto assets. We already have seen that there are fewer cases related to ICOs.¹³ In 2020, 12 of the 16 (75%) cryptocurrency enforcement actions alleging fraud involved an ICO, whereas only 8 of the 13 (61.5%) cryptocurrency enforcement actions alleging fraud involved an ICO in 2021. The ICO craze began gaining in popularity in 2017 where “some 800 ICOs [were] offered, raising a total of about \$20 billion.”¹⁴ Because of the rapid growth in the industry and a purported lack of controls and disclosures, seemingly leading to huge

⁸ Simona Mola, *SEC Cryptocurrency Enforcement: Q3 2021 Update*, available at <https://www.cornerstone.com/insights/reports/sec-cryptocurrency-enforcement-q3-2021-update/> (Exhibit 1 depicting number of SEC cryptocurrency actions by calendar quarter, Q3 2013–Q3 2021).

⁹ *Id.* (Exhibit 4 table depicting types of cryptocurrency enforcement actions by calendar quarter, Q3 2013–Q3 2021).

¹⁰ *Liu v. Securities and Exchange Commission*, 140 S. Ct. 1936, 1950 (2020).

¹¹ Mola, *supra* note 8.

¹² *Id.*; see also Simona Mola, *SEC Cryptocurrency Enforcement: 2021 Update*, available at <https://www.cornerstone.com/wp-content/uploads/2022/01/SEC-Cryptocurrency-Enforcement-2021-Update.pdf>.

¹³ “Spotlight on Initial Coin Offerings,” available at <https://www.sec.gov/ICO> (last accessed Feb. 2, 2022). Notably, the SEC website lists five cases as “ICO updates.” Four of these five cases were initiated and/or an order issued in Q3 2020; only one occurred in Q1 2021. In addition, four of the five cases included allegations of fraud.

¹⁴ Jeff Kauflin, “Where Did The Money Go? Inside the Big Crypto ICOs of 2017” (Oct. 29, 2018), available at <https://www.forbes.com/sites/jeffkauflin/2018/10/29/where-did-the-money-go-inside-the-big-crypto-icos-of-2017/?sh=b8448e8261bb>.

losses, Nic Carter, a former Fidelity analyst who cofounded the crypto VC firm Castle Island Ventures, predicted that “2019 will be the year of ICO lawsuits.”¹⁵ And so it was, with the uptick in ICO enforcement actions further extending into 2020. As the SEC cracked down on ICOs, market participants grew more sophisticated, focusing both legitimate and illegitimate efforts in other spaces. For example, 2021 saw an increase in retail/consumer scams relating to crypto. For example, the Federal Trade Commission (“FTC”) has reported that, between October 2020 and May 2021, there was a significant increase in consumer reports of cryptocurrency scams, with over 7,000 individuals reporting more than \$80 million lost—twelve times the number of reports and nearly 1,000% more in reported losses over the same period in the prior year.¹⁶

The Number of Crypto Enforcement Actions Brought Against Individuals for the Unregistered Offering of Securities Is Increasing

Chair Gensler repeatedly has emphasized the importance of holding individuals accountable.¹⁷ In 2021, we saw the SEC focus on individuals, including senior executives and officers, in crypto-related actions. We expect this trend to continue in 2022.

Before 2021, actions against individuals in non-fraud cryptocurrency cases under Section 5 of the Securities Act of 1933 were exceedingly rare.¹⁸ In 2021, this trend began to shift. The SEC brought two lawsuits—*Coinseed*¹⁹ and *Rivetx*²⁰—naming executives in actions under Section 5 in which there were no allegations of fraud. The amounts alleged by the SEC to have been raised through unregistered offerings in *Coinseed* and *Rivetx* are also *de minimis*, as compared to earlier crypto asset cases: \$141,000, and \$18 million, respectively (with only 30% of the funds raised in *Rivetx* alleged to have come from United States investors).

From the face of the *Coinseed* and *Rivetx* complaints, there seems to be no defining characteristic that would determine whether an executive will be included as a defendant in a lawsuit under Section 5. Nevertheless, given the SEC’s announced intention to bring more cases involving individuals and gatekeepers in all areas, we anticipate that crypto enforcement actions in 2022 will continue to assert claims against individuals, particularly chief executives and chief financial officers.

Civil Penalties, as a Percentage of Disgorgement, Are on the Rise

In fiscal year 2021, which ended on September 30, 2021, the SEC “obtained judgments and orders for nearly \$2.4 billion in disgorgement and more than \$1.4 billion in penalties, which

¹⁵ *Id.*

¹⁶ Emma Fletcher, “Cryptocurrency buzz drives record investment scam losses” (May 17, 2021), *available at* <https://www.ftc.gov/news-events/blogs/data-spotlight/2021/05/cryptocurrency-buzz-drives-record-investment-scam-losses>.

¹⁷ Gensler, *supra* note 2.

¹⁸ Importantly, the SEC does not need to prove scienter, intent, or recklessness to prevail on a claim under Section 5. *See e.g., Securities and Exch. Comm. v. Sason*, 433 F. Supp. 3d 496, 510 (S.D.N.Y. 2020) (“Section 5 is a strict liability statute, meaning even unwitting sales of impermissibly unregistered stock constitute violations.”).

¹⁹ *SEC v. Coinseed et al.*, 21-cv-01381-PGG (S.D.N.Y.) (lawsuit brought by the SEC against Coinseed and its chief executive officer for alleged violations of section 5(a) and 5(c) of the Securities Act).

²⁰ *SEC v. Rivetz Corp. et al.*, 21-cv-30092 (D. Mass.) (lawsuit brought by the SEC against Rivetz Corp., Rivetz International SEZC, the President and Director of Rivetz Corp., and a Director of Rivetz International, for alleged violations of section 5(a) and 5(c) of the Securities Act).

represented a respective 33 percent decrease and 33 percent increase over amounts ordered in the prior fiscal year in these categories.”

Cases involving crypto assets mirrored this trend. In fiscal year 2020, disgorgement in SEC crypto enforcement actions was approximately \$1.28 billion, while penalties were more than \$31 million (*i.e.*, penalties were just 2.4% of disgorgement).²¹ In contrast, in fiscal year 2021, disgorgement in crypto enforcement actions was approximately \$523 million, while penalties were more than \$52 million (*i.e.*, penalties were 10% of disgorgement).²²

Nevertheless, we have not yet observed a sea change in the way in which disgorgement is calculated in individual crypto asset cases. In *Liu v. Securities and Exchange Commission*, 140 S. Ct. 1936 (2020), the U.S. Supreme Court held that the SEC may seek disgorgement as an equitable remedy in judicial proceedings as long as that disgorgement award (1) does not exceed a wrongdoer’s net profits, and (2) is awarded for victims constitutes an equitable remedy within the scope of the SEC’s statutory authority. In so holding, the Supreme Court made clear that legitimate business expenses should be deducted from the amount that the SEC can seek in disgorgement, and that, before an award of disgorgement may issue, there must be a determination whether a distribution to harmed investors is feasible.²³

Given that there is now a clear requirement to deduct legitimate business expenses from awards of disgorgement, one might expect to see a significant decrease in the amount of disgorgement awarded in SEC crypto cases, particularly in cases in which money was not fraudulently raised, and therefore arguably are no “illegitimate” business expenses.

That was not the case in *GTV Media Group Inc. et al.* (“*GTV Media*”), however. In *GTV Media*, the Respondents agreed to pay \$486.7 million in disgorgement, despite having raised “approximately \$487 million.”²⁴ In addition to appearing to agree to pay a disgorgement award equal to the total amount raised, with no offset for legitimate business expenses, the Respondents were also required to pay \$17.6 million in pre-judgment interest and \$35 million in civil penalties.²⁵

The SEC’s order does not provide any information about the way in which disgorgement was calculated in *GTV Media*, and we do not know whether Respondents requested—and the SEC rejected—an offset for legitimate business expenses, or whether the disgorgement amount reflects a negotiated amount. Moreover, to date, there is little guidance as to what the SEC will consider a legitimate business expense in negotiating offsets to disgorgement amounts. Nor did the Supreme Court, in *Liu*, provide an itemized list of what qualifies, although the Court did distinguish between a

²¹ These figures are calculated excluding pre-judgment interest and include amounts that were ordered during the referenced fiscal year, regardless of when an action was initially brought.

²² The order to disgorge 190 Bitcoin in *SEC v. Trevon Brown*, ECF 33, 21-cv-04791 (S.D.N.Y. Jul. 9, 2021) (further discussed below in note 27) is not included in these calculations. In August 2021, 190 Bitcoin were estimated to be worth \$9.25 million. See Andrew Hayward, “BitConnect Promoters Pay \$12M in Cash, Bitcoin to Settle \$2B Alleged Scam,” (Aug. 20, 2021), <https://decrypt.co/79066/bitconnect-promoters-pay-12m-bitcoin-cash-settle-sec>.

²³ See *e.g.*, *Securities and Exchange Commission v. Bevil*, 2:19-CV-0590-RFB-DJA, 2020 WL 7048263, at *2 (D. Nev. Nov. 30, 2020) (denying SEC’s request for disgorgement because it failed “to identify whether the disgorgement award is for the benefit of investors”).

²⁴ *GTV Media Group Inc. et al.*, Securities Act Release No. 10979 (Sept. 13, 2021), available at <https://www.sec.gov/litigation/admin/2021/33-10979.pdf>.

²⁵ *Id.*

legitimate business expense and expenses that are “wholly fraudulent” in furtherance of a scheme to defraud.²⁶ We expect that this landscape will continue to evolve in 2022, though we do not anticipate that there will be complete clarity on these questions any time soon.²⁷

II. What Might We Expect in 2022?

Absent Congressional action clarifying (or requiring the SEC to clarify) the regulations applicable to crypto assets, the SEC will likely continue to regulate this space through enforcement in 2022.

We anticipate that the SEC will bring increasing numbers of crypto enforcement actions, with a focus on offers and sales of securities in unregistered transactions under Section 5, whether or not they involve fraud. We also anticipate that the SEC will continue to target the listing and trading of crypto assets on U.S. platforms.²⁸ The SEC likely will increase its focus on individual liability, including by senior executives and gatekeepers, and in cases in which there are no allegations of fraud. Moreover, the SEC will press (particularly in settled actions) for payment of full monetary relief, however divided between disgorgement and civil penalties, with nominal offsets (if any) for legitimate business expenses.

Meanwhile, those operating in the crypto asset space—and their counsel—will continue to pick through the breadcrumbs of the SEC’s filed actions in an attempt to best ensure compliance with the nebulous framework of applicable regulation and best situate themselves to avoid SEC scrutiny.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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²⁶ *Lin*, 140 S. Ct. at 1950.

²⁷ Notably, any award of disgorgement need not be in cash. In 2021, at least one court ordered that disgorgement of bitcoin. On July 9, 2021, the U.S. District Court for the Southern District of New York entered a final judgment against Defendant Joshua Jeppesen in *SEC v. Trevon Brown*, ordering Mr. Jeppesen, among other things, to surrender all title, right, and interest in 190 Bitcoin stored in his wallet as disgorgement. *SEC v. Trevon Brown et al.*, ECF 33, 21-cv-04791 (S.D.N.Y. Jul. 9, 2021) (ordering disgorgement of 190 Bitcoin).

²⁸ Gensler, *supra* note 2.