

# Goodmans<sup>LLP</sup> Update

## Lessons From the SEC's Recent Settlements With Unregistered Cryptocurrency Firms

On September 11, 2018, the US Securities and Exchange Commission (SEC) announced its settlement of enforcement actions against two issuers engaging in the offer and sale of cryptocurrencies where, for the first time, the firms and their control persons were charged with failing to register as a broker-dealer and investment company.

The settlements are the next step following the SEC's continued scrutiny of the sale of cryptocurrencies, and indicate what to expect from the Canadian Securities Administrators (CSA).

### TokenLot

TokenLot was a limited liability company marketing itself as an "ICO superstore," where retail investors could trade in digital tokens during and after an initial coin offering (ICO).

The SEC noted in its [order](#) that TokenLot "actively and broadly" solicited the general public by advertising tokens available on TokenLot's website through social media, forums, newsletters, websites, and paid internet advertising. Further, the SEC took the position that the company operated as a dealer by purchasing discounted tokens during ICOs and reselling them to retail investors for a profit.

The SEC found TokenLot and its owners failed to register the company as a broker-dealer and offered unregistered securities for sale. TokenLot was disgorged of its profits and its two owners were required to pay a civil penalty. The owners were banned from participating in the securities industry, with the right to apply for re-entry after three years. TokenLot's remaining digital tokens were destroyed as part of its winding down process.

### Crypto Asset Management (CAM)

CAM was a hedge fund managing the Crypto Asset Fund (CAF), a pooled investment vehicle formed to invest in digital assets. Between August 1, 2017 and December 1, 2017, the fund raised over US\$3.6 million from 44 investors, primarily individuals. CAM marketed itself as the "first regulated crypto asset fund in the United States."

In its [order](#), the SEC stated that CAM and its owner did not have pre-existing relationships with the investors and engaged in a general solicitation of interest in the offering through CAM's website, social media accounts and media outlet interviews. Additionally, from January 2018 onwards, CAM was offering securities pursuant to the exemption from registration as contained in *US Regulation D*, Rule 506(c), similar to the accredited investor exemption in the CSA's *National Instrument 45-106 – Prospectus Exemptions*.

CAM was charged with failing to register CAF as an investment company, offering and selling unregistered securities, and making material misrepresentations about the offering to prospective investors in a pooled investment vehicle. CAM and its owner were ordered to pay a reduced civil penalty as a result of CAM's cooperation with the SEC and its attempts at remediation, such as halting the offering, reviewing its website and promotional materials, verifying the accredited status of investors, disclosing its misrepresentations and offering rescission to each accredited investor.

### Lessons for the Canadian Cryptocurrency Space

These recent settlements demonstrate that the SEC is continuing to pursue its regulatory crackdown on cryptocurrency offerings, and is willing to enforce sanctions against firms and control persons even absent of fraud charges. Individuals and issuers in Canada involved with purchasing and selling cryptocurrencies should consider:

- **Registration as a Dealer or Adviser:** Companies and individuals transacting in cryptocurrencies should consider whether they are required to register with a provincial securities regulator. Canadian securities regulators are continuing to monitor and scrutinize

unregistered companies targeting investors. On May 18, 2018, the Ontario Securities Commission issued an [alert](#) cautioning Ontario investors to be wary of five unregistered firms soliciting and advising on cryptocurrency investments. Shortly thereafter, 40 North American securities regulators launched “[Operation Cryptosweep](#)” to raise awareness about fraudulent activity in cryptocurrency investment schemes, resulting in [200 active investigations](#) into ICOs by the end of August.

- **Liability of Control Persons:** The SEC did not shy away from imposing sanctions on the individual owners/operators of TokenLot, and also held the individual control persons jointly and severally liable for the civil penalties imposed on both TokenLot and CAM. Persons who are deemed to be “control persons” of an entity engaging in the purchase and sale of cryptocurrencies should not disregard there may be personal liability arising from their role as control persons of those entities.
- **Social Media:** Notably, the SEC focused on the marketing efforts of both companies on their social media and online channels. Companies should be mindful of their social media presence and determine whether their social media posts can constitute a solicitation.

Companies and individuals transacting in cryptocurrencies should continue to consider whether transactions in a digital asset qualify as an offer or sale of a security. The CSA confirmed in [Staff Notice 46-307: Cryptocurrency Offerings](#) and [Staff Notice 46-308: Securities Law Implications for Offerings of Tokens](#) that cryptocurrencies can be securities, and cryptocurrency transactions may have to comply with Canadian securities law requirements. These Staff Notices were discussed in our August 30, 2017 Update, [Initial Coin Offerings in Canada: The CSA Weighs In](#) and our June 12, 2018 Update, [Focus on Substance Over Form – CSA Provides Further Guidance on Token Offerings](#).

For further information relating to this Update, please contact any member of our [Securities Law Group](#) or [Technology Group](#).

## Goodmans Technology Group

To assist clients in the technology sector, Goodmans brings together our acknowledged expertise in corporate/commercial, private equity, corporate finance, mergers and acquisitions, outsourcing, licensing, intellectual property, privacy, regulatory and media, tax, litigation, human resources, corporate restructuring and administrative law. We do so both for innovative businesses in their start-up phase and for well established businesses of all types. Goodmans continues to lead in the technology sector and is partnered with the DMZ at Ryerson University. The DMZ is a leading business incubator (selected by UBI as the top-ranked university incubator in North America, and third in the world), which connects its startups with resources, customers, advisors, investors, and other entrepreneurs. Goodmans is also a proud partner of IDEABOOST, an initiative of the Canadian Film Centre’s Media Lab; building the next generation of technology-based media entertainment products, services and brands. Through these partnerships, Goodmans provides legal advice, mentorship and networking opportunities to assist startups in maximizing their potential. Outsourcing technology functions and technology procurement is also a major strength of Goodmans, where we have assisted technology users to transform their businesses. Finally, Goodmans has represented in court and in arbitrations major technology providers, and users of technology, in ground-breaking cases that have made important contributions to the development of technology law. Members of our Technology Group teach internet and communications law at Canada’s largest law schools, are regular lecturers at technology industry events and legal conferences, and have published articles in the technology law field.

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