

# A Tale of Two Crypto Cases

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*CryptoCounsel*

June 5, 2024

Wiley Podcast · A Tale of Two Crypto Cases

In Episode 2 of the *CryptoCounsel*, hosts Josh and Frank decode recent litigation with the SEC and two key cases in the Southern District of New York. In the first case, a judge found that Ripple's cryptocurrency XRP is not a security when sold to individual investors. But in the second case, a different SDNY judge found that 13 of Coinbase's listed cryptocurrencies are securities. These divergent cases underscore the complexity and uncertainty of applying existing securities laws to cryptocurrencies, which will continue to be contested in the courts.

## Transcript

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Josh Simmons

Welcome to the *CryptoCounsel* at Wiley, where we decode the most important crypto issues in litigation and arbitration. I'm Josh, an international lawyer who does crypto disputes.

Frank Scaduto

And I'm Frank, a securities lawyer who also does crypto disputes.

Josh Simmons

Great to be with you again, Frank.

## Related Professionals

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## Practice Areas

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Frank Scaduto

You too, Josh.

Josh Simmons

Last time you told us a little bit about orange groves and definitions of security and how they apply to cryptocurrency. These are the important esoteric and existential issues facing crypto in the U.S. and in the world and today let's unpack a little more how this is going to play out practically before the government, before the courts, but before we do that, our three quick bits to get going. First, recent news is that the former CEO of Binance has been sentenced to four months in prison and in bigger news before that, the former CEO FTX was sentenced for 25 years. Frank, is this fair or not?

Frank Scaduto

I mean, so, the Binance yes, is the short answer, Josh. The Binance CEO pled guilty, agreed to a larger package deal of \$4 billion that would be recovered by the government, and did not put the United States Department of Justice through the process that Sam Bankman-Fried chose, which was to go to trial and test his case and that's just what happens when you roll the dice, so fair.

Josh Simmons

In other news, some celebrities have been endorsing crypto. One of those is the famous former NFL star Rob Gronkowski and the news is that he recently settled a dispute, the litigation that was brought against him for his role in promoting a cryptocurrency lender. Does this mean that celebrities should stop endorsing crypto or should they keep going?

Frank Scaduto

I would say you should probably stop, maybe put a pause, cool that for a moment. I will say, I'm not a Boston sports fan, so Gronkowski got what he deserved.

Josh Simmons

I remember, I think it was a Super Bowl ad when Matt Damon came out with, *fortune favors the brave*. That was in favor of crypto.com, right?

Frank Scaduto

That was when many were starting to think of crypto as maybe not entirely what they had thought it was and could be. So, yes, big turning point.

Josh Simmons

Well, for you celebrities out there, *fortune still favors the brave*, so don't be too deterred by the recent settlement of this litigation. You agree?

Frank Scaduto

Ah, Matt Damon's doing just fine; very solid career.

Josh Simmons

Third bit today is a little more in line with what we're going to be discussing and this is recent news that the SEC has served a Wells notice on Robinhood, the popular trading platform, which some say suggests that the SEC intends to sue Robinhood. Is this surprising or not, Frank?

Frank Scaduto

Very surprising, Josh. Robinhood has been about as careful as a trading platform in its position can be with respect to crypto. They had actually removed certain tokens from the platform because they were worried that the SEC was going after them, after those tokens that is, and so people had thought that Robinhood was proactively trying to play nice and the SEC doing this is a big shock I think to them and to everyone else that's following the space.

Josh Simmons

If the SEC's goal is something like intimidation or fear, it's probably succeeding because there's a lot of uncertainty but we've talked a lot about the SEC, both in the last episode and with the bits today. So before we get too far into the substance, let's pause. We're Washington, D.C. lawyers. We're wired into Washington. We don't want the alphabet soup to be deprived of the other great acronyms. The Securities and Exchange Commission is only one player in this soup. Who are the other players who could or should be regulating cryptocurrency?

Frank Scaduto

The most obvious one that comes to mind is the CFTC, Commodities Futures Trading Commission. There are a lot of commodities aspects of cryptocurrencies and CFTC already does play a role in overseeing and regulating within the jurisdiction that it does have. So there is some sense that the CFTC and the SEC are the two most obvious ones to do it and then you sort of have a host of what are more behind the scenes, sort of quasi-criminal authorities that deal with Bank Secrecy Act and money laundering regulations that tend to get involved in any sort of currency related matter from a regulatory perspective. So some of those are also in the mix in terms of who is doing stuff and who should be doing stuff.

Josh Simmons

So there's a lot of potential players here and I suspect we'll be seeing more and more as time passes but the SEC has been claiming most of the fame in part because of the litigation and the enforcement actions that it has been bringing. We talked last time about the efforts to require a rulemaking by the SEC, which could provide some potential clarity around this space, but that's not happened yet and instead we have litigation and two cases that have been pending are in the Southern District of New York. Frank, what can you tell us about the Southern District of New York?

Frank Scaduto

So this is the federal court in Manhattan where a lot of financial disputes get litigated and a lot of the law grows from decisions by this court. Obviously, New York being a financial center of the world, this has been a place where a lot of these kinds of cases tend to go and the judges that are very familiar with them. They have a high degree of fluency in the players, the types of cases, the kinds of discovery disputes that are likely to arise, they've tried these cases, it's a bench of people who are either did this in their private practice before they were put on or have certainly— or not just private practice, but also as prosecutors for the Southern District of New York U.S. Attorney's Office or the U.S. the S.C.C. in New York or here in Washington, D.C. So it's a bench of judges who are very familiar with these kinds of disputes.

Josh Simmons

And certainly some of the big players in Manhattan they would know. You could think of Goldman Sachs or J. P. Morgan but there's some new players now and the SEC has been bringing claims against them; those include Coinbase, as we discussed, but also Ripple. What can you tell us about Ripple?

Frank Scaduto

So, the Ripple, well Ripple has a token, XRP that the SEC has—

Josh Simmons

Speaking of acronyms, does XRP stand for something?

Frank Scaduto

If it does, I will have to look it up.

Josh Simmons

I'm sure it's related to x-rays.

Frank Scaduto

So, XRP, the SEC says is a security and therefore needs to comply with all the various securities regulations and they brought this lawsuit against Ripple. It's being heard by a judge in the Southern District named Judge Torres and the interesting thing about this case is it's been one of the few success stories for the crypto

industry in terms of a judge putting some real meaningful limits on the SEC's position that all of crypto is essentially a security, or at least everything other than Bitcoin.

Josh Simmons

If I'm remembering correctly from our last episode, the question is whether XRP is an orange grove. Is that right?

Frank Scaduto

Yeah, so you have to, you know, put yourself back in the world as it existed in 1946 and think, how would a judge determine my cryptocurrency dispute using a test about orange groves?

Josh Simmons

So why is XRP not an orange grove?

Frank Scaduto

So some of it is, and some of it isn't. The some of it that is like the orange grove investment contract from that case involves the direct sales of this token to institutional investors, larger investors with a greater degree of sophistication and those folks would have a basis to understand and to expect the generation and common sharing of profits from Ripple as the quote unquote issuer to again put it in security speak but then there was a second group of purchasers of this token. People like you, me, or anyone else who might buy or sell tokens on an exchange and in that situation the secondary market purchases, Judge Torres, she created a distinction for what she called blind bid asks, meaning you don't know who you're buying from, you don't know who you're selling to, and by extension you don't know where that profit is being created, who it's going to. So she said with that group, there is no orange grove analogy that holds. So she said that's not a security.

Josh Simmons

And for those listeners who might not understand the functionality of a cryptocurrency, is that right or wrong about the blind bid ask?

Frank Scaduto

It sort of depends on your vantage point of are you a crypto user because you're speculating on its value or are you a crypto user because there are features of the technology or the ability to use it as a currency to buy and sell pretty much anything increasingly. So for the former group, the speculators, it, you know, there is a little bit of—

Josh Simmons

Let's call them investors to be fair— wait, that could be risky.

Frank Scaduto

Yeah, exactly, not for expectation of common profit from a third party but even with that group in Judge Torres's understanding, there was still this blind bid ask problem that it was essentially an anonymous exchange that you couldn't trace back sort of how this money was generating a communal profit in the same way that the orange grove contract and the growing of the oranges and the sale and then it comes back into a pot of money that gets divvied up among all the people that invested with the Howey Company from that foundational case.

Josh Simmons

And what about the second category? These are those trying to use cryptocurrency as a currency.

Frank Scaduto

For those, I mean, just the notion that it's a security I think it's hard to grasp because it feels a lot like cash or a credit card or any other sort of commodity that money often is. It's not an investment vehicle; it's just something you use to buy and sell stuff. So I think it's much harder for people to see any sort of analogy to the test that governs the securities distinction.

Josh Simmons

Results have been mixed but I have to give my shout out of *fortune favoring the brave* to those countries around the world who have implemented cryptocurrency as a national currency. That's going to be an interesting development. We'll see how that plays out.

Frank Scaduto

Yeah, there are a few, and I think there will be more and more. I mean, a lot of companies, public companies, even in the United States, use cryptocurrency as a source of stability in their own treasury department. So I mean, countries, large institutions, it's happening.

Josh Simmons

So that's Ripple and XRP, and there's a favorable decision there by Judge Torres that I think many in the cryptocurrency community have been celebrating as a promise, a light at the end of the tunnel for some of these challenges and this uncertainty posed by SEC enforcement actions but that wasn't the final word. There's another case pending in the same court, Southern District of New York, with Coinbase. What can you tell us about that, Frank?

Frank Scaduto

Yeah, so for folks that are not familiar with these courthouses, there's obviously, you know, a courthouse, the Southern District of New York in this case, but then there could be 30, 40 judges that sit in that courthouse, and each one is its own little mini sovereign. They all sort of, obviously, subject to appellate law and Supreme Court law have to apply the law, but they each have their own, you know, balls and strikes to call. So in the Coinbase case of the Southern District of New York, different judge, Judge Fela, she was hearing an SEC challenge to Coinbase's trading platform and whether or not 13 cryptocurrencies that are traded on that platform are securities and therefore whether Coinbase can offer those securities on its platform without registering as a platform to do that and—

Josh Simmons

Why 13 by the way? Is that just chosen by the SEC as an unlucky number, an omen for how they think the case will turn out?

Frank Scaduto

Perhaps. I think it was just the 13 at the time but it did not, obviously, it did not bode well for the fortunes of Coinbase. So those 13, which I believe it must be maybe except for Bitcoin, which maybe they're in fact 14, but the unlucky 13 were found to be securities and Coinbase by extension has to treat them as securities and there's some interesting differences to what Judge Fela did versus what Judge Torres did that I think are illustrative of why this whole regulation by enforcement approach by the SEC is so problematic, which is Judge Fela looked at this broader ecosystem of the cryptocurrency world and the networks that they are attached to and she said, well, even if I can't draw perfect analogies between the cryptocurrencies themselves, and the orange groves from the Howey case, this whole way in which crypto works and the way it came into being and the fact that there is in fact this group of people that launched these, some of these networks, like Ethereum and some of the others and have these native tokens that are a source of currency created by the networks. That's the bigger picture that I'm looking at and I can say that that's more like the orange grove investment contract situation that the Supreme Court uses as its touchstone.

Josh Simmons

Let me pause you there because this word ecosystem, I think is really interesting in this space. I think most of us know what an ecosystem is. Is ecosystem a defined term in the Securities and Exchange Act?

Frank Scaduto

Definitely not. I mean, it is, this is a word that obviously, in the tech world has become very popular and it has no definition or roots in the Securities and Exchange Commission's rules, laws that created them. This is a construct that she's attempting to map onto this new technology.

Josh Simmons

So Brazilian rainforest; that's an ecosystem I can get my mind around. Orange grove. I get that too. The ecosystem of cryptocurrency. It seems like a somewhat vague, amorphous concept on which to be regulating crypto. Do you agree?

Frank Scaduto

Yeah, I think it gets back to some of what we talked about in the first episode, which is there's the technology and then there's the sort of the products or the currencies or the tokens or the things that the technology facilitates and there's innovation happening across both of those aspects, but the network technology, whatever blockchain is created to administer it and how it's designed and coded, that's one thing and then you have the tokens themselves, that's another thing. And then how they're promoted is a third thing altogether and I think, and we talked about this last episode, some judges and some folks at the SEC and some commentators want to collapse all that and I think that's dangerous because behind all this is just sort of neutral technology.

Josh Simmons

Neutral but incredibly complex and sophisticated. I think one of the things that's really tough here is that you have fast moving technology that a lot of people don't really understand from the block chain to particular cryptocurrencies. How are they different? How do they function? At the same time you have an incredibly complex regulatory process; you have complex laws, and even Supreme Court precedent, and how those two come together, I think is why we're here. We want to try to understand how do you apply a complex legal system, often in litigation, which is its own messy thing, to a complex technology and so on that point we now have two opposed decisions. Not directly because as you said, each judge has responsibility for the cases before them, and so they are entitled and allowed to come to different conclusions, but they have. You have the Ripple case. XRP is not a security and then you have the Coinbase case; 13 ominous cryptocurrencies, opposite conclusion. Where does this head? How do we resolve this conflict?

Frank Scaduto

Well, in just those two cases and where they go, they could theoretically go to the same Court of Appeals, which would be the Second Circuit Court of Appeals, which is in New York as well, and then from there they could go on up to the Supreme Court. This process is playing out in courts not only in Manhattan in the Southern District but in other courts across the country and so if conflicts are going to be created in enough of a sizable amount then this stuff will go up through the appellate courts and then possibly to the Supreme Court. The alternative to all that that I think many people would prefer to see would be Congress steps in and says, *no, here's the clear law that we're putting in place, and we're giving you a clear regulator who has a clear mandate with clear boundaries*. Those are the sort of two options at this point.

Josh Simmons



Well, I think we've been in D.C. long enough to know that the prospects of swift congressional action that is going to holistically resolve this problem are low.

Frank Scaduto

Very low. It would take a large systemic shock to the economy from this industry for I think Congress to do anything. I mean, FTX was what it was, and that has not moved the needle. I think you would need a wholesale crisis, essentially.

Josh Simmons

The states are stepping in, right? So states are regulating. They are doing more but I think there's a third option here, which is why not have more clarity from the Executive Branch of the federal government? Why hasn't there been rulemaking so far?

Frank Scaduto

Well, speaking to the SEC, I think they are just genuinely unprepared to try to create the broad enough set of rules and I think they thrive, the Enforcement Bureau thrives in just going after specific cases, deciding them on the facts and trying to litigate them one by one and the process of building the regulations, I think, is too daunting for them and the other piece of it is that's only one half of it and the less important half they have to not only do that, but come up with a scheme for if they are subject to SEC regulation, what has to happen? I mean, these are decentralized entities; they're not going to issue public financial reports the way Apple or Google or you know, a publicly traded company does and there's got to be some entirely separate set of consequences for being regulated by the SEC in the case of crypto.

Josh Simmons

So we've covered the legislative branch in the Executive Branch where we think it's unlikely to have clarity in the near future about how to regulate crypto and then we're back to the third branch, the Courts. Are we going to get clarity from the courts? Right now we have mixed outcomes in the Southern District of New York. What are your hopes there?

Frank Scaduto

My hopes are low. I think that judges are trained at dealing with a case in front of them with its particular facts, its particular issues, and you're going to get a very uneven hodgepodge of rules to the point where it might be if you're operating in, New York, you have one set of rules and if you're operating in Texas, you have a different set of rules. It could be that insane.

Josh Simmons

So this is sounding dire, but I want more hope. Crypto is a new frontier; *fortune favors the brave*. What's the hope when there's these uncertainties from regulation and even litigation? How should crypto companies be approaching this uncertainty?

Frank Scaduto

I think the industry has been incredibly proactive and you see companies like Coinbase who are actively asking the SEC to go through a rulemaking process and they want to contribute to that conversation and come up with a framework that makes sense. So I think there is a lot of proactivity. There is a lot of innovation. I think there will continue to be a lot of energy around coming up with solutions that can comply with the regulations as they currently are on the assumption that all this are subject to SEC enforcement but ultimately the thing that will take the restrictor plates off the whole industry would be a clear pronouncement, it would have to be from the Supreme Court at this point, that there is some aspect of this that is subject to regulation and there is some aspect that is not and some clear rules of the road.

Josh Simmons

I think it's a testament to the crypto industry writ large that they are taking matters into their own hands rather than I think some people look at the entrepreneurial space and there's commentary like *move fast and break things* but here while crypto is moving fast, they are actually trying to use the courts to get more clarity from the government about regulation. Has this happened in other industries before?

Frank Scaduto

I can't really remember it happening quite this way. Usually it's, you break it and then you ask for forgiveness. The crypto companies are being very proactive in a, I think totally appropriate and healthy way, and I think a lot of these lawsuits that we're seeing from the companies and the developers and the trade associations for which, you know, these companies are members, they're getting out in front of the courts and saying, *hey, wait, this is not the right way to do it* and I think it's allowing the conversation to happen more quickly and the courts to more thoroughly address the range of issues so that hopefully we'll get a definitive ruling sooner rather than later.

Josh Simmons

Let's hope so. So I think we've covered in the first episode whether cryptocurrency is a security. Unfortunately, the answer is that's not clear. Now we've discussed how are we going to figure it out and that also, it seems is a little bit unclear but one thing that is clear, and you can see this from the actions that the cryptocurrency companies are taking is that this is a thriving industry. It is growing and it's not going to go away because of lack of clarity. So what do you think the next step is in terms of the SEC's regulation?

Frank Scaduto

I think that the, hopefully there will be a turning of the tide and the SEC will lose enough of these cases against the big players in the industry that it will understand it needs to shift tactics and undertake a rulemaking or look to Congress and say, *look, you know, if we're going to do something, tell us what* but we're at a, we're not quite at a turning point but I think that there is a lot of momentum by the crypto industry to counterbalance and push back on what the SEC has tried to do over the last couple years.

Josh Simmons

Well I think we have a lot of momentum as the CryptoCounsel trying to understand this. You think so?

Frank Scaduto

Absolutely.

Josh Simmons

Well, let's keep at it. We're going to continue monitoring this space. We've talked about SEC regulation and the related litigation, but there are a lot of other topics we could cover here. You talked about money laundering, there's international disputes, a whole host of issues that are coming up with crypto infrastructure, investment, blockchain, and we're going to be covering these. If you are interested in this space, please reach out. Let us know. We'd love to host you on CryptoCounsel at Wiley. Please post a review. Thank you for listening. *Fortune favors the brave.*

**Frank Scaduto**

Matt Damon.