

**Lex Mundi Blockchain White Paper Series**

# Minimizing Litigation Risk for Crypto and Blockchain Companies

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It was my first big trial. I was putting on our key expert. The judge had been on the bench for decades, and I was worried. How was I supposed to explain the subtleties, nuance, and relevant technology to the Court? With the help of my expert witnesses, I succeeded, but I reflected on that experience recently as I contemplated litigating issues related to cryptocurrencies and blockchain. Litigating technical issues is always tough, but litigating crypto cases will be even tougher. If counsel and the clients they represent are not prepared, that challenge will be almost insurmountable. Companies and aspiring crypto counsel, therefore, should consider these lessons.

## Crypto is More than Meets the Eye

I confess. I am a millennial. But the Transformers slogan is particularly relevant in this context. Distributed ledger technology involves myriad concepts—public and private key cryptography, hashing, consensus mechanisms, and more—and each protocol is different. Counsel must spend sufficient time to actually understand the technology and appreciate the differences or they will be at a significant disadvantage.

By way of example, a partner of mine recently organized a mock trial to demonstrate how practitioners can get distributed ledger entries into evidence. He and three fellow blockchain litigators—a former SEC Enforcement Branch Chief, a former federal prosecutor, and the General Counsel of a cryptocurrency company—collaborated on the event and tried the case in front of a sitting federal judge. Even though everyone understood the issues, they disagreed on the best way to address the issues up until the actual event. In the end, they settled on one carefully selected exhibit from a blockchain explorer service. A single transaction entry required three separate witnesses just to lay the necessary foundation for this exhibit. Had the exercise been a real trial, the plaintiff would have had to obtain and plan for the entry of the relevant evidence far in advance. Consequently, attorneys with clients in the space must understand these issues and clients need to be able to identify and select competent crypto counsel.

## New Technology ≠ No Rules or New Rules

The Crypto community is often likened to the Wild Wild West, a place devoid of law and order. Regulators and other authorities, however, have repeatedly demonstrated that this tired analogy is untrue. Conscientious

counsel warned of securities issues for years, but many companies did not heed those warnings. Then, the SEC's Rule 21(a) Report from July 2017 (the Dao Report) and subsequent enforcement actions removed all doubt: the '33 and '34 Acts, the *Howey* test, and the other, relevant regulations and tests all apply to crypto companies and products. The CFTC, IRS, Department of Justice, Department of Treasury, and state and international authorities, moreover, have also stated or demonstrated that the laws on the books apply with equal force to the crypto community.

Companies simply cannot avoid existing laws and regulations because they have a crypto bent. If a client engages in money transmission (even crypto to crypto transactions), then it should evaluate whether it needs to register with FinCen and obtain state money transmitter licenses. If companies are working with competitors in blockchain consortia, they need to consider whether there are any anti-competition or other issues. And if a business wants to issue a token, it should only do so after hiring counsel that understands the relevant securities laws.

### **Litigators Gotta Litigate**

Many companies with tenuous connections to the crypto industry might think that they are immune from crypto and blockchain litigation. They are incorrect. If you have any connection to the space, you may become involved in a lawsuit. YouTube was recently brought into the Bitconnect litigation because, as the Plaintiff alleged, the company should have been aware that its business partners were promoting the exchange and that the exchange was a scam. See *In re BitConnect Securities Litig.*, No. 9:18-cv-80086 (S.D. Fla.). Mobile phone companies, likewise, have been sued for failing to protect customers from crypto hacks. See *Terpin v. AT&T Inc. et. al.*, No. 2:18-cv-6975 (C.D. Cal.). If you have any interests in crypto or blockchain technology or are even crypto-adjacent, be prepared.

### **Be Careful Not to Kick Over the Beehive**

In his classic tome, *How To Win Friends and Influence People*, Dale Carnegie opined that “[i]f you want to gather honey, don’t kick over the beehive.” Some crypto companies have taken a rather different approach. Kraken, for example, was served with a request for information from the New York Attorney General’s Office, along with most other prominent exchanges. Kraken’s CEO tweeted that the request was abusive and Kraken did not formally respond to the NYAG’s request. The New York Attorney General’s report took exception with Kraken’s response (or lack thereof), noting “Kraken platform’s public response is alarming. In announcing the company’s decision not to participate in the Initiative, Kraken declared that market manipulation ‘doesn’t matter to most crypto traders,’ even while admitting that ‘scams are rampant’ in the industry.” The report went on to indicate that the Attorney General’s office had referred Kraken and two other exchanges to the New York Department of Financial Services to evaluate whether the exchanges had violated New York’s virtual currency laws. Although Kraken may have had sound reasons for not responding, its public response certainly did not improve its relationship with New York regulators.

### **Technology Does Not Move at the Speed of Litigation**

Blockchain technology is evolving at a rapid pace. While a number of securities, contract, and even bankruptcy actions have been initiated by or against blockchain and crypto companies, those actions are still typically very

early in the litigation lifecycle. Rulings and orders should trickle out over the next few years in these and other matters, the result of which may be to dramatically alter the legal landscape. Just because something seems lawful now, does not mean that the judges assigned to these cases will agree. Tread carefully and hire an attorney who stays abreast of these developments.

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