

Federal Judge Rules Securities Laws May Cover ICOs

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U.S. District Judge Raymond Dearie of the Eastern District of New York has [ruled](#) that initial coin offerings (ICOs) may be subject to securities law. The ruling came in the court's denial of defendant Maksim Zaslavkiy's motion to dismiss an indictment that alleges that he committed securities fraud for selling tokens that he claimed represented shares in a real estate venture and a separate diamond business. Zaslavskiy's motion to dismiss argued that the investment schemes and their related ICOs did not involve securities and are beyond the reach of federal securities laws and that the securities laws, specifically the Exchange Act and SEC Rule 10b-5, are unconstitutionally vague as applied to this case.

Judge Dearie found that the indictment is constitutionally sufficient and meets the pleading requirements of the Federal Rules of Criminal Procedure. As for the application of securities laws, to state a valid claim of securities fraud under Section 10(b), the allegedly fraudulent conduct must involve a "security." The definitions of "security" in the relevant securities laws includes "investment contracts," and whether the investment schemes at issue in this case are investment contracts is a question reserved for the ultimate fact-finder, which will be required to conduct an independent [Howey](#) analysis based on the evidence presented at trial. At the motion to dismiss stage, the court must decide whether the "elements of a profit-seeking business venture" are sufficiently alleged in the indictment such that, if proven at trial, a reasonable jury could conclude that investors provided the capital and shared in the earnings and profits, and that the promoters managed, controlled and operated the enterprise. Judge Dearie concluded that such elements were sufficiently alleged in the indictment, and that if such allegations were proven, they would permit a reasonable jury to conclude that Zaslavskiy promoted investment contracts.

With respect to Zaslavskiy's argument that the securities laws are unconstitutionally vague as applied, the court said that the Exchange Act, Rule 10b-5, and the definition of "investment contract" in *Howey* taken together make it reasonably clear at the relevant time that the charged conduct was criminal. Judge Dearie noted that securities laws are meant to be interpreted flexibly. Furthermore, he stated that case law interpreting *Howey* and related guidance issued by the SEC about its regulatory authority and enforcement power provide the notice that is constitutionally required (here, Judge Dearie cited to the [DAO Report](#) and [public statements made by Chairman Clayton](#) on cryptocurrencies and initial coin offerings). Moreover, Judge Dearie stated that these securities laws set forth the types of behavior that constitutes securities fraud and that they are intended to prevent the conduct described in the indictment.

Judge Dearie's denial of the motion to dismiss means that the case will proceed to trial, where Zaslavskiy is free to argue that, under the *Howey* test, the relevant tokens were not investment contracts. We will provide updates on this case as it moves to trial.

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