Proskauer

Warning Shot: Charges Against OneCoin Include Securities Fraud

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In early March, the Manhattan U.S. Attorney unsealed indictments against the leaders of the Bulgarian-based "purported" cryptocurrency "OneCoin" on wire fraud, money laundering and federal securities fraud charges relating to an alleged $3 billion pyramid scheme devised to market OneCoin. OneCoin's lawyer has also been charged with conspiracy to commit money laundering for allegedly conducting financial transactions with some of the proceeds of the scheme to conceal the unlawful activities.

The Manhattan U.S. Attorney alleges that the defendants created a fraudulent cryptocurrency, OneCoin, in 2014 for the sole purpose of defrauding investors. The OneCoin team encouraged members of its multi-level-marketing network to recruit others to purchase OneCoin cryptocurrency packages, which is one of the reasons why worldwide membership swelled to over three million, generating billions in sales. OneCoin represented that the value of OneCoin is based on market supply and demand, whereas the indictment contends that the value of OneCoin was in fact determined internally and its growth in "value" from €0.50 to €29.95 was fraudulently orchestrated by OneCoin. OneCoin marketed to investors that it used a private blockchain to track OneCoins and record historical transactions, but the indictment alleges that it did not permit investors to verify the existence of their OneCoins, and that the defendants allegedly began allocating OneCoins that did not even exist in the blockchain. OneCoin claimed that it mined the OneCoin cryptocurrency using services operated by the company, when in fact, according to the U.S. Attorney, no mining was done at all. Further, according to the indictment, to lure in investors Ruja Ignatova, co-founder of OneCoin, falsely represented to investors than an "initial public offering" of OneCoin would occur in 2018 and 2019.

The securities fraud charge against Ignatova states that “in connection with the purpose and sale of securities,” Ignatova “did use and employ manipulative and deceptive devices and contrivances,” which is contrary to SEC Rule 10b-5. To succeed on this charge, ultimately the U.S Attorney must prevail in establishing, as a threshold matter, that OneCoin’s tokens were offered as “securities.”

The definition of “security” in the federal securities laws includes “investment contracts,” and a determination as to whether there are investment contracts is subject to an independent *Howey* analysis based on the evidence presented at trial. Should the case proceed to trial, its outcome may produce further case law regarding the circumstances under which a digital asset ostensibly offered as a form of cryptocurrency may actually be deemed a securities offering.

The criminal securities fraud charges against OneCoin are not the first such charges to be brought against promoters of a cryptocurrency. Similar charges were brought against Maksim Zaslavskiy in November 2018 for fraudulently marketing tokens from REcoin Group Foundation, LLC and DRC World, Inc. Zaslavskiy tried to dismiss the securities charges by asserting that securities laws did not apply to cryptocurrency offerings, but the court held that a jury was entitled to decide if REcoin and DRC tokens were securities because merely calling something a cryptocurrency does not necessarily remove the offerings from the scope of securities laws.