

# SEC Sues Crowd Machine for Allegedly Fraudulent and Unregistered ICO

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In its first enforcement action of the year involving ICOs, the U.S. Securities and Exchange Commission (SEC) charged two companies and their founder for violations of antifraud and registration provisions of the federal securities laws in connection with an initial coin offering (ICO). On January 6, 2022, the SEC [announced](#) charges against Australian citizen Craig Sproule and two companies he founded, Crowd Machine, Inc. and Metavine, Inc. (collectively, the Defendants), for making materially false and misleading statements in connection with an unregistered offer and sale of digital asset securities in an ICO. ([SEC v. Crowd Machine, Inc.](#), No. 22-00076 (N.D. Cal. filed Jan. 6, 2022)).

These charges add to the SEC's [growing list of enforcement actions](#) that target unregistered offerings of digital assets. ICO activity peaked in 2017, when hundreds of issuances raised an estimated \$5 billion from investors. Since that time, [scrutiny from the SEC](#) has cooled this practice. However, the SEC remains vigilant in taking action against unregistered ICOs, based on its view that digital tokens are likely to be securities. In [remarks](#) last year, SEC Chairman Gary Gensler voiced agreement with [former SEC Chairman Jay Clayton's position](#) on ICOs: "To the extent that digital assets like [initial coin offerings, or ICOs] are securities — and I believe every ICO I have seen is a security — we have jurisdiction, and our federal securities laws apply."

The SEC's [complaint](#), filed in the Northern District of California, alleges that Sproule, the self-titled "Man behind the Machine" in social media postings, and other Defendants claimed to have raised \$40.7 million in an ICO of Crowd Machine Compute Tokens (CMCTs) between January and April of 2018. Defendants told investors that proceeds would be used to develop technology to host Metavine's existing "no-code" application development software in a decentralized "Crowd Computer" blockchain system.

The SEC alleges that the sale of CMCTs was an illegal unregistered offering of securities and describes various facts to support its claim that the tokens are an investment contract. For example, the Defendants allegedly emphasized that the success of the project was dependent on the efforts of their company's management team and structured the offering to encourage "speculative purchases" by deliberately capping the amount of CMCTs and promising to create a secondary market for trading in CMCTs. The complaint also notes that the tokens had no use at the time of purchase. Each of these factors is consistent with the SEC's well-established analysis of digital assets under the *Howey* test for investment contract.

The SEC alleges that the Defendants did not qualify for an exemption from the registration requirements of the federal securities laws. The complaint claims that Defendants knowingly sold CMCTs to "ICO pools" – groups of investors who pool money together, then transfer funds to an accredited investor to participate in the offering – without determining whether the underlying individuals (including individuals in the U.S.) were accredited investors. The SEC further alleges the Sproule himself served as a representative of at least two such ICO pools, collecting funds from and distributing CMCTs to individual investors without confirming their identities and accredited status.

The SEC's complaint also alleges that Defendants made materially false and misleading statements about the use of proceeds from the sale of CMCTs. The "Crowd Computer" system that the Defendants were purportedly building never materialized. Instead, the SEC alleges that the Defendants diverted more than \$5.8 million in ICO proceeds to gold mining entities in South Africa – a use that was not disclosed to investors. Interestingly, the complaint notes that the largest single purchase of CMCT in the ICO purportedly came from a single purchaser, a Malaysian gold mining company.

Sproule and Crowd Machine consented to judgments permanently enjoining them from a number of activities, including participating in future securities offerings and Sproule acting as an officer or director of a public company. In addition, Sproule agreed to pay a \$195,047 civil penalty. Metavine Pty. Ltd, an affiliated Australian entity, and Crowd Machine consented to pay disgorgement, as the court orders, up to the amount received in the offering. All consented-to-judgments remain subject to court approval.

This complaint sets a strong tone for another year of continued SEC enforcement against unregistered ICOs and misleading and fraudulent statements in connection with the offering of digital asset securities. The complaint's focus on the use of ICO pools containing un-accredited, U.S. investors indicates that attempts to skirt existing exempt-offering requirements will likely be met with heavy scrutiny by the SEC – particularly when those violations are coupled with allegations of defrauding investors.

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