

CLIENT ALERT

JURY DIVERGES FROM SEC IN FINDING THAT DIGITAL ASSETS ARE NOT SECURITIES

On Monday, November 1, 2021, a jury sitting in the United States District Court for the District of Connecticut delivered a verdict declaring that certain digital asset products issued by GAW Miners LLC (“GAW Miners”) under the direction of its principal Stuart Fraser were not securities in *Audet v. Fraser*.

The GAW Miners business model involved the sale of equity in cryptocurrency mining profits through the sale of “Hashlets.” According to plaintiffs, when investors expressed dissatisfaction with the limitations inherent to Hashlets, GAW Miners announced the launch of a proprietary cryptocurrency called Paycoin. Customers could opt to convert their currently held Hashlets into promissory notes that could be purchased or mined that could later be exchanged for Paycoin when it launched. These promissory notes were called “Hashpoints.” Alongside Hashpoints, GAW Miners introduced “Hashstakers,” which were digital wallets that could lock up Paycoin for 30, 90, or 180-day terms and generate fixed returns. When GAW Miners launched Paycoin, it touted the digital currency as having a \$20 price floor and as being widely accepted by well-known institutions, which were allegedly false statements.¹ Mr. Fraser was accused of control person liability in connection with the allegedly fraudulent statements made by GAW Miners and its other founder, Homero Joshua Garza, pursuant to Section 20(a) of the Securities Exchange Act of 1934 and Section 36b-29(c) of the Connecticut Uniform Securities Act (“CUSA”), and with Aiding and Abetting Common Law Fraud and Fraud in the Sale of Securities in violation Section 36b-29(a)(2) of CUSA.

The jury was instructed by the Court to apply the test set out in *SEC v. W.J. Howey Co.* to each of the products alleged to be securities. To find defendants liable on plaintiffs’ securities-based claims, the Court instructed jurors that “a suitable place for you to begin is to determine whether the plaintiffs have proved that one of the four Products at issue – Hashlets, Hashpoints, Paycoin, and Hashstakers – are ‘securities.’ The plaintiffs allege that the Products are ‘investment contracts, which are a type of security. To establish that a Product is an ‘investment contract,’ the plaintiffs must prove that there was, with regard to that Product: (1) an investment of money; (2) in a common enterprise; (3) with profits to be derived solely from the efforts of others... If you do not find that a particular Product satisfies the three above-listed criteria for an investment

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¹ First Amended Complaint, *Audet v. Fraser*, 16-cv-00940-MPS, ECF Doc. No. 57 at ¶¶ 7-8 (Nov. 4, 2016).

contract, then that Product is not a security and you should find for Mr. Fraser on the four securities claims with respect to that Product.”²

After deliberating, the jury returned a verdict form indicating its findings that none of the four Products at issue was a security, necessitating a finding of no liability for Mr. Fraser on the four securities claims. Mr. Fraser was also found not liable on an aiding and abetting claim with respect to a fraud charge against GAW Miners.³

The verdict is remarkable for its break with the Securities and Exchange Commission’s position that Hashlets are investment contracts in the action it brought against Mr. Garza in 2015.⁴ This difference is demonstrative of the uncertainty which currently characterizes much of the regulatory landscape facing individuals and entities operating in the cryptocurrency space. Certainly, this verdict diminishes SEC Chair Gensler’s recent remarks that the SEC ‘has never lost a case’ when alleging a digital asset is a security⁵. We expect to see findings increasingly diverge as courts, regulators, and civil juries grapple with questions about the regulation of cryptocurrencies.

				
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² Jury Instructions, *Audet v. Fraser*, 16-cv-00940-MPS, ECF Doc. No. 326 at 20-21 (Oct. 29, 2021).

³ Verdict Form, *Audet v. Fraser*, 16-cv-00940-MPS, ECF Doc. No. 330 at 2 (Nov. 1, 2021).

⁴ Complaint, *SEC v. Garza et al.*, 15-cv-01760, ECF Doc No. 1 at ¶ 3 (Dec. 1, 2015) (“Defendants sold shares in the returns from their purported mining operations, via investment contracts that they named ‘Hashlets.’”).

⁵ Remarks Before the Aspen Security Forum, <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>