RIKER DANZIG SCHERER HYLAND PERRETTI LLP

# Cryptocurrency Investment Companies Violate N.J. State Securities Law

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The New Jersey Bureau of Securities has ordered two cryptocurrency-related investment entities, Bitcoiin 2nd Generation ("B2G") and Bitstrade, to stop offering unregistered securities in the state. A Cease and Desist Order against Bitstrade was entered on February 9, 2018, and a similar order against B2G was entered approximately one month later, on March 7th. Specifically, B2G was actually offering cryptocurrency and Bitstrade was offering opportunities to buy cryptocurrency at what it categorized as "below market" rates.

The Bureau of Securities found that the crypto-related investments offered by both B2G and Bitstrade constitute "securities," and, based on this finding, issued the Cease and Desist Orders based on the following violations:

- Offering investors unregistered securities in their own cryptocurrency; and
- Failing to disclose key material facts to prospective investors, including the identities of their principals, the physical addresses of their businesses, information about their financial condition, and the risks associated with an investment in their cryptocurrency.

This enforcement comes during a time where cryptocurrency is permeating the media. As a relatively new industry that is largely unregulated, there is uncertainty on how to characterize cryptocurrency under federal and state securities law.

Cryptocurrencies are stored electronically using blockchain technology and do not require a singular, trusted third party, such as a bank, to complete a transaction. Cryptocurrency investment entities who wish to participate in these crypto-transactions usually raise capital through Initial Coin Offerings ("ICO"), in which they typically allocate cryptocoins or tokens to investors in exchange for some other form of cryptocurrency or legal tender. The

entities running the ICO campaigns attract investors by touting the possibility that a successful cryptocurrency project can translate into a much higher cryptocoin value than what the investors purchased it for before the project was initiated.

Section 2(1) of the Securities Act of 1933, as amended (the "Securities Act"), defines "security" as including any "investment contract." In SEC v. W.J. Howey Co., the U.S. Supreme Court defined the term "investment contract" to mean "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party…." 328 U.S. 293, 298-99 (1946). Section 5 of the Securities Act requires all sales of securities to be registered with the United States Securities and Exchange Commission ("SEC"), unless a specific exemption is available.

New Jersey, like virtually all other states, also regulates the sale of "securities" and, accordingly, issuers and investors must carefully navigate the dual federal/state regulatory dichotomy.

While it may be unclear whether the crypto-related investments offered through ICOs or otherwise are securities within the meaning of the definition above, any such analysis is fact-intensive and requires a careful analysis of the underlying transaction. Certain ICOs may not be securities, but applicable regulatory bodies are providing enhanced scrutiny of such transactions.

The SEC issued an investigative report on Decentralized Anonymous Organization's coin offerings, concluding that a fact-sensitive inquiry is necessary to determine whether a particular ICO is a security. Because the SEC does not broadly classify all ICOs as securities offerings, it continues to urge caution on such offerings in the cryptocurrency industry.

Before acting as an investor or issuer of any ICO or crypto-related offering, it would be prudent to consult securities and regulatory counsel. Please contact Robert Frucht, Jason Navarino, Robert Daleo, Ronald Leibman or any member of Riker Danzig's Corporate and Securities Group if you have any questions regarding this topic.

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