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SEC Warns Investors About 'Coin Offering' Fraudsters

By **Matthew Perlman**

Law360, New York (August 29, 2017, 1:25 PM EDT) -- The U.S. Securities and Exchange Commission told investors Monday they should be wary of companies claiming involvement with initial coin offerings, because they may just be trying to exploit excitement around the new digital-token technology in order to fraudulently manipulate the market.

The SEC issued an investor alert saying that public companies may claim to provide exposure to so-called ICOs, in which digital tokens are exchanged for money or digital currency, as a way to convince potential victims to invest in what turn out to be pump-and-dump and other market manipulation scams, pointing to a string of recent trading suspensions.

“While these activities may provide fair and lawful investment opportunities, there may be situations in which companies are publicly announcing ICO or coin/token related events to affect the price of the company’s common stock,” the alert said.

The warning comes a month after the commission issued its first formal guidance on ICOs, saying they may in some cases constitute securities that fall under current federal regulation, and that its approach to enforcement would be guided by “economic realities” instead of the labels businesses use.

The insight came through an investigative report into a German group known as The DAO, a so-called decentralized autonomous organization that used blockchain technology to raise about $150 million last year. The SEC found that tokens like those used in The DAO’s coin offering are considered securities under U.S. law despite some suggestions to the otherwise.

Josh Klayman, who leads Morrison & Foerster LLP's Blockchain and Smart Contracts Group, told Law360 on Tuesday that while this report provided some guidance, and showed that token offerings can be considered securities, it didn’t create any bright line rules because it only looked at the specific facts surrounding DAO.

The commission’s education and advocacy office also issued a bulletin last month, warning investors about the potential risks of participating in ICOs, including the limited recovery options if something goes wrong.

In its alert Monday, the SEC noted the recent trading suspensions of First Bitcoin Capital Corp., CIAO Group, Strategic Global and Sunshine Capital, which the commission said made claims about their investments in coin offerings or other token-related activity.

First Bitcoin Capital Corp.'s shares were temporarily suspended on Aug. 24, with the SEC citing concerns about the accuracy and adequacy of publicly available information about the company, including the value of assets and its capital structure.

First Bitcoin responded the same day with a letter to its shareholders, suggesting the suspension was instituted in part because of a "need to diminish the extraordinary demand" for its shares. It also said it believed the action was "drastic" and likely the result of a misunderstanding that could be cured with a simple clarification.

Klayman said that while the alert may in part be a response to First Bitcoin's letter or others like it which seek to minimize the gravity of a temporary trading suspension, there's no way to tell. What is clear, she said, is that the commission is signalling that it is well aware of the amount of activity taking place in the token space, and wants to put people on warning.

"They're showing that not only are they attune to this, they're telling investors, and companies that are issuing tokens, that they need to be careful," Klayman said.

--Additional reporting by Jack Newsham. Editing by Emily Kokoll.

Update: This story has been updated to include comments from Klayman.
