

## Securities Attys Challenged By New Role As ICO Gatekeepers

By **Dunstan Prial**

*Law360 (May 24, 2018, 6:05 PM EDT)* -- As regulators, lawmakers and the courts struggle for a uniform set of rules for regulating initial coin offerings, attorneys on the front lines of the cryptocurrency frenzy are adapting to their role as gatekeepers, a responsibility they describe as both challenging and frustrating.

Working in a new area of technology with little more than guidance from the U.S. Securities and Exchange Commission — as well as a stern warning from the agency’s Chairman Jay Clayton — securities attorneys who advise clients seeking to raise money by issuing digital tokens say playing it safe is the smartest advice.

“My job is to deliver value to the clients and say, ‘Look, this is the environment we’re in, these are the things you need to do to protect yourself and your customers,’” said Amit Singh, a shareholder at Stradling Yocca Carlson & Rauth PC. “There is a whole package of issues you have to deal with and none of them are simple, but I think there are lower-risk strategies to follow.”

Clayton has made no secret of his belief that most ICOs are securities that should be registered with the SEC. SEC registration requires disclosures and an overall level of transparency that reduces the likelihood of fraud, the chairman has said.

Clayton has also made no secret of his view that securities attorneys need to play a key role in protecting investors from ICO fraud. “Market professionals, especially gatekeepers, need to act responsibly and hold themselves to high standards,” Clayton told a conference in January. “To be blunt, from what I have seen recently, particularly in the initial coin offering space, they can do better.”

When the SEC refers to gatekeepers, the agency is typically referring to either outside counsel who advise companies on financial matters or accountants who do the same, said Keir Gumbs, a partner in Covington & Burling LLP’s Washington, D.C., office. In the case of ICOs, accountants are less of a factor because they’re not as involved in the decision-making process as the lawyers, according to Gumbs.

“As a lawyer, it’s challenging,” said Gumbs. “We all have the desire to give clients what they want. And, as you can imagine, in many cases the client does not want to characterize their product as a security because there can be significant implications for doing that,” he said.

What Clayton was suggesting, according to Gumbs, is that attorneys resist the temptation to please their clients and instead cast a skeptical eye on ICO deals because the SEC is also going to be skeptical, he said.

"I think it was a bit of a warning shot," Gumbs added. "What Jay Clayton was saying was, 'We're going to hold lawyers accountable for things that happen involving potential violations of securities laws by companies conducting ICOs.'"

Gumbs said the SEC's enforcement staff has a long history of pursuing lawyers in cases in which the staff thinks a lawyer knowingly or recklessly advised a client to engage in activity that would violate the registration provisions of the Securities Act.

Despite ample warnings from the SEC that ICOs can be risky ventures, especially for unsophisticated investors, the appetite for digital token offerings continues to grow; the number of offerings and the amount of money raised by issuers in the first half of 2018 have nearly eclipsed the figures for all of 2017. According to figures compiled by ICOdata, 765 ICOs have raised \$4.8 billion so far this year, compared to 871 ICOs that raised \$6.1 billion a year ago.

JR Lanis of Drinker Biddle & Reath LLP said the SEC has been "emphatic" in its emphasis that ICOs are subject to abuse and fraud. "The challenge is that the regulators are asking us, the attorneys, to curtail that abuse and fraud," he said.

For "honest" attorneys, keeping fraud out of their clients' ICOs is easy, according to Lanis. The hard part of being an ICO gatekeeper is helping clients "do the right thing" by helping them determine whether their ICO should be registered with the SEC, because "as of now we really have no rules," he said. "It's like trying to hit a moving target blindfolded."

The SEC is currently handling the surge in ICOs through "legislation by enforcement action," Lanis said.

"It's frustrating because we have clients who want to do the right thing but they're still being viewed suspiciously," he said. "We're using 100-year-old laws to deal with a 21st-century technology."

Singh said he's telling his clients, "100 percent, when in doubt, it's a security."

Because the SEC is using the so-called Howey test, named for a Supreme Court ruling that for decades has been used to determine if a financial instrument is an investment contract and therefore a security, Singh said he uses that test as well. "If there's any question, then assume it's a security and treat it as such," he said.

Singh said that for all the supposed lack of clarity on how ICOs should be regulated, the SEC has been fairly straightforward in its approach. The agency has gone after "clear fraudsters," including Ponzi schemers and issuers just trying to raise money without building anything, as well as issuers that conducted legitimate ICOs but who should have registered their tokens with the SEC, according to Singh.

"It's not like the SEC's got any malice," Singh said. "They are really interested in protecting investors. I think we're in a gray area, but that's what lawyers do. If the SEC had made it abundantly clear what a security was, where do I provide any value? My value is really between the lines in taking the lower-risk strategy."

Singh said before he agrees to accept an ICO client, one of the first things he asks is whether the client is building a real business or just looking to "cash out."

Gumbs said it's not a "new thing" for the SEC to hold outside counsel responsible for the opinions they give to clients.

"What does it actually mean to be a gatekeeper?" he asked. "It means that you're the person standing at the gate that lets people in or out. And in the context of a security offering, you're the person that's offering an opinion that's basically the gate for the people conducting the offering. If you don't give that opinion, people may not invest."

Essentially, what the SEC is saying to lawyers is that if they are the ones giving the opinions that provide investors with access to capital via cryptocurrencies and ICOs, then the SEC is going to hold them accountable, and that's fair, Gumbs said. What concerns him, though, is what might happen if an attorney acts in good faith for a client but the SEC disagrees with the lawyer's opinion.

"It's unfair if you throw the book at somebody who exercised good faith and was thoughtful and careful and yet just came out in a place that was different from where the SEC staff came out," Gumbs said.

The SEC did not respond to a request for comment for this story.

--Editing by Pamela Wilkinson and Alanna Weissman.