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LITIGATION TRENDS IN CRYPTOCURRENCY

CRYPTOCURRENCY CONFERENCE

Law and Regulation



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- **Cryptocurrency is a new global phenomenon with heavy financial implications and unclear regulation.**
- **Because of the lack of comprehensive regulation, this market is highly sensitive to any legal decision.**
- **It only makes sense that a decision in Israel's Supreme Court will echo in Europe and the US.**
- **litigation with regard to cryptocurrencies is pretty new and there are not a lot of court decisions – globally.**



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LITIGATION IN CRYPTOCURRENCY CAN BE DIVIDED TO FOUR CATEGORIES:

A. **Regulatory Litigation and Proceedings**

Litigation initiated by regulatory bodies such as the SEC, CFTC, DOJ, FTC and FinCEN. Usually those proceedings involve fraudulent behavior mostly with regard to ICOs. As for now there are 25 cases in the US.

B. **Summary Suspensions / Cease and Desist Orders**

For example – the Massachusetts Securities Division has recently issued consent orders requiring permanent suspension of five ICOs, claiming those ICOs were selling 'unregistered securities'

C. **Civil litigation involving investors in ICO's, including class actions**

22 cases in the US alone most of them class actions; 3 class actions in Japan with regard to the stealing of 500 Million NEM tokens worth 530 Million USD on January 2018 from Coincheck exchange. One class action in Israel.



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D. Litigation brought by crypto companies against regulators or key market players such as banks

Bits of Gold v. Bank Leumi; Chile - a legal proceeding initiated recently in Chile by three cryptocurrency exchanges that local banks shut down their accounts; India – a crypto trading platform company that filed a petition to the High Court in Delhi against the Reserve Bank of India, regarding its decision of prohibiting banks work with cryptocurrencies related entities; Russia – where the Supreme Court has directed to hear an appeal about a decision to block a website giving information about cryptocurrencies.



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CASES FOR DISCUSSION:

Florida v. Espinoza (Florida 11th Circuit Court 2016)

CFTC v. McDonnell and CabbageTech (U.S. District Court, Eastern District of New York 2018)

SEC v. AriseBank, et al. (U.S. District Court, Northern District of Texas 2018)

Bits of Gold Ltd. v. Bank Leumi (Supreme Court of Israel 2018)



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FLORIDA V. ESPINOZA (FLORIDA 11TH CIRCUIT COURT 2016)

- This is one of first cases dealing with Bitcoin trading
- in February 2014, Mr. Espinoza was charged for unlicensed money transmissions and AML violations after selling bitcoins to an undercover detective on the peer-to-peer trading website LocalBitcoins.
- Judge Teresa Mary Pooler, dismissed all charges because the courts could not deem bitcoin as money.
- In her decision Judge Pooler wrote: “The court is not an experts in economics,” “However, it is very clear, even to someone with limited knowledge in the area, the Bitcoin has a long way to go before it [becomes] the equivalent of money.”
- “For a court to find a defendant guilty of unlicensed money transmission in Florida, the defendant must have transmitted currency, monetary value, or payment instruments without proper licensing”



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“specifically, that because virtual currency creates no claim or obligation, its sole means of ever becoming currency is finding a willing buyer. The dollar is recognized as legal tender in the United States, requiring the government and Federal Reserve officials to accept it as payment of taxes, fees, and loan payments. Bitcoins are released into circulation as a result of software users performing tasks within the software, and there is no obligation on anyone's part to accept bitcoins in exchange for goods, services, taxes, fees, or other payments. Therefore, there is no guarantee that virtual currency, such as Bitcoin, can be converted to sovereign currency. Based on Bitcoin's lack of intrinsic value, the exchange of bitcoins for currency is no different from a buyer purchasing any commodity.”



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- The State of Florida filed an appeal, there's no decision yet.
- On may 2017, Florida's legislature added "virtual currency" to the definition of "monetary instruments" covered within its anti-money laundering (AML) statute

This case is important as it shows the elusive character of Cryptocurrency and how the court is struggling to put a new technological and financial phenomena into irrelevant statute definition.



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CFTC V. MCDONNELL AND CABBAGETECH (U.S. DISTRICT COURT, EASTERN DISTRICT OF NEW YORK 2018)

This decision was given at March 6, 2018, by Judge Jack Weinstein of the Eastern District of New York.

The facts:

Patrick McDonnell and his company offered trading and investment services related to virtual currency.

Customers paid for “membership” in virtual currency trading groups that promised to provide exit prices and profits of up to “300%” per 5 weeks.

McDonnell provided minimal, if any, virtual currency trading advice and never achieved the promised return on investment and misappropriated the funds of the investors.



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CFTC V. MCDONNELL AND CABBAGETECH (U.S. DISTRICT COURT, EASTERN DISTRICT OF NEW YORK 2018)

A preliminary injunction is granted in favor of the CFTC.

The interesting thing in this decision is the thorough review about the current and future regulation of cryptocurrency.

For example, the court said that:

"Congress has yet to authorize a system to regulate virtual currency. ("As the CFTC recently admitted, U.S. law does not provide for 'direct comprehensive U.S. regulation of virtual currencies. To the contrary a multi-regulatory approach is being used.'"). The CFTC, and other agencies, claim concurrent regulatory power over virtual currency in certain settings, but concede their jurisdiction is incomplete."



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SEC V. ARISEBANK, ET AL. (U.S. DISTRICT COURT, NORTHERN DISTRICT OF TEXAS 2018)

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AriseBank was intended to be the world's first "decentralized" bank, where customers could get traditional banking services denominated in cryptocurrency. The bank aimed to raise \$1 billion through sales of its own coin, AriseCoin. Before its assets were frozen, AriseBank claimed to have raised \$600 million from investors.

The SEC saw AriseCoin as a security being offered to investors, which requires registration with the SEC, which was not done. AriseBank also claimed in marketing that it had acquired "100-year-old commercial bank". That was a fabrication and not true.



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SEC V. ARISEBANK, ET AL. (U.S. DISTRICT COURT, NORTHERN DISTRICT OF TEXAS 2018)

SEC has successfully frozen the assets of AriseBank under emergency provisions, halted its ICO, and the court has appointed a receiver to manage the assets and ensure they can't be liquidated.

This was the first time the SEC has sought the appointment of a receiver in connection with an ICO fraud.



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BITS OF GOLD LTD. V. BANK LEUMI (SUPREME COURT OF ISRAEL 2018)

This is a decision in a temporary relief request and not a final judgment.

The facts:

Bits of Gold is a company engaged in trading “Bitcoin” and had a bank account in Bank Leumi for since 2013.

When opening the bank account, Bits of Gold informed the bank that its purpose is to be a broker for buying and selling Bitcoin.

Two years later the bank announced Bits of Gold that it forbids using the account for any kind of activity relating to trade in Bitcoin.

Bits of Gold filed a complaint to the District Court in Tel Aviv against the Bank's decision.

In its judgment dated June, 2017. the District Court decided that the Bank's decision to forbid Bits of Gold to carry out any kind of activity relating to trade in Bitcoin is within reasonable bounds; and therefore, there is no room for intervention by the court.



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Before concluding its judgment, the district Court noted that the conclusion it has reached does not impose any blemish as to the conduct of the Company and added that apparently “it acted with complete transparency and did not violate any provision of law”.

Bits of Gold filed an appeal to the supreme court and a motion for temporary relief .

In the motion, the Company argued that the Bank cannot shut down its account on vague accusation and must point to concrete acts and transactions in the Account causing real concern of prohibited activity. Since the Bank did not lift such burden, the Bank's refusal to provide services to the Company is unreasonable and contrary to its duties under the Banking Law.



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Bitcoin trading activity is not prohibited by law, and it is unreasonable for the Bank to conduct itself as a “super-regulator” simply because it is not interested in managing the risks related to such activity.

The Bank argued that if the Motion be granted, it will suffer considerable damage, since it shall be required to allow activity that raises real concern of being contrary to the provisions of law and to its banking policy.

The Bank argued that it serves as the long-arm of the State for preventing unlawful or suspicious financial activity. Therefore, once the Bank found that the Bitcoin trading activity cannot be tracked, traced or monitored, not only is the Bank's Decision reasonable, it is even required under law.



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BITS OF GOLD LTD. V. BANK LEUMI (SUPREME COURT OF ISRAEL 2018)

The court decided to approve the temporary motion.

As for the damages that could be caused to the Bank should the Motion be granted – the court decided that they are "at this stage nothing but speculation. The Bank's Decision is based on the assumption that the Company's activity bears risks that constitute violation of the provisions of law, and therefore the Bank may pay a price for materialization of such risks. However, to this day, for over five years in which the Account is active, such concerns did not materialize...More so, the Bank has tools to prevent materialization of the risks it is pointing to, including the Bank's ability to prevent transactions it suspects are unlawful."



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BITS OF GOLD LTD. V. BANK LEUMI (SUPREME COURT OF ISRAEL 2018)

The importance of the Supreme Court decision in this temporary motion is that the court was not "frightened" by the bank arguments with regard to its "inability" to manage the risk with regard to Bits of Gold account, and rather, preferred to check the relevant facts of the case. After checking the facts, the supreme court reached a conclusion that the damages that the bank argues may happen if the temporary order is given – is nothing but speculation.



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WHAT THE FUTURE HOLDS:

A surge in court decisions

A lot of new cases coming to courts

Litigation regarding catastrophes



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SOME INSIGHTS AND CONCLUSIONS:

- Cryptocurrencies pose huge challenges to the courts.**
- Judges should focus on relevant facts and apply known legal principles.**
- Complete bans may bring court intervention.**



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THANK YOU!