Securities Regulation Daily Wrap Up, BLOCKCHAIN—S.D.N.Y.: Ripple to pay $125M for unregistered sales, (Aug 8, 2024)

By Anne Sherry, J.D.



Ripple took the court judgment as a victory, given that the SEC had asked for much steeper penalties.

Charged only with determining remedies for Ripple's unregistered institutional sales of XRP tokens, the district court in Manhattan ordered first-tier penalties totaling just over $125 million. The SEC had asked for disgorgement and $876 million in penalties, with Ripple countering that it should pay no more than $10 million, but the court ruled that disgorgement was unavailable and the correct penalty was in between the parties' requests. While the recurrent registration violations were a serious offense, there was no fraud, and the SEC did not establish that the failure to register institutional sales created risk to investors (*SEC v. Ripple Labs, Inc.*, No. 20-cv-10832 (S.D.N.Y. Aug. 7, 2024)).

Ripple CEO Brad Garlinghouse lauded the decision on X. "This is a victory for Ripple, the industry and the rule of law," he tweeted. "The SEC's headwinds against the whole of the XRP community are gone."

Background. Last summer, the court issued a split ruling holding that the sales of XRP tokens to institutional investors constituted the unregistered offer and sale of investment contracts in violation of Section 5 of the Securities Act, but that the "programmatic" sales of tokens to retail investors, for example on crypto trading platforms, were not unregistered sales of securities. The SEC unsuccessfully sought interlocutory appeal. Then, the agency dropped its aiding-and-abetting claims against Garlinghouse and executive chair Christian Larsen.

As a result of the court's decisions and the dismissal of the individual defendants, no trial was necessary, and the only outstanding issue was determining the proper remedies against Ripple for the unregistered institutional sales.

Injunction warranted. First, the court agreed with the SEC that Ripple should be enjoined from further registration violations. Applying the factors from *SEC v. Cavanagh*, 155 F.3d 129 (2d Cir. 1998), the court noted that Ripple had been found liable for Section 5 violations that spanned eight years and involved 41 counterparties. *Cavanagh*'s scienter factor was inconclusive in this case because the SEC did not allege enough facts to support an inference that Ripple recklessly disregarded the securities laws.

Cavanagh also factors in the defendant's willingness (or not) to accept blame, and this factor came out in favor of an injunction. Ripple admitted that after the court's order defining institutional sales as including sales to ODL customers, Ripple continued selling XRP in ODL transactions. This doesn't necessarily mean that Ripple's recent sales have violated Section 5—but the firm's "willingness to push the boundaries of the Order evinces a likelihood that it will eventually (if it has not already) cross the line." This reasonable probability of future violations warranted an injunction.

The court also declined to waive the bad actor disqualification provisions, seeing as Ripple had not cited any authority for judicial waiver.

***Govil* bars disgorgement.** Following *SEC v. Govil*, 86 F.4th 89 (2d Cir. 2023), the court determined that the SEC was not entitled to disgorgement of Ripple's profits from institutional sales. *Govil* held that a "victim" for disgorgement purposes is one who suffers pecuniary harm. Here, the SEC offered only speculative evidence that the XRP institutional buyers did not receive the return on the investment that they expected at the outset. Some investors

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may have been able to negotiate better deals if they knew via SEC disclosures what discounts had been offered to others, but this does not establish that they suffered pecuniary harm by paying the price they did.

Civil penalties. Finally, the court determined that maximum first-tier penalties were appropriate. The SEC asked for $876 million, equivalent to the net profits for the institutional sales, while Ripple argued for $10 million, approximating its gross revenues. The court opted for a tailored approach instead of what it called the "virtually all-or-nothing requests" of the parties.

There was no question that the recurrent, highly lucrative registration violations amounted to a serious offense. But there were no allegations of more culpable conduct such as fraud or misappropriation. The SEC did not establish that Ripple's failure to register caused substantial losses or risk to investors.

Given that Ripple will not pay disgorgement, a larger penalty was appropriate to impose a punitive effect. And it was uncontested that Ripple's current financial situation did not warrant a reduced penalty. Accordingly, the maximum first-tier penalty was appropriate for each violation.

To determine the total penalty, the court next allied the violations involved. Section 5's registration requirement is transaction-specific, so it followed that each unregistered transaction was a separate violation. Based on the court's analysis of Ripple's expert report summarizing the relevant contracts, the court found 1278 violations, resulting in a civil penalty of $125,035,150 when accounting for the dates of the various violations.

The case is No. 20-cv-10832.

Judge: Torres, A.

Attorneys: Jorge Gerardo Tenreiro for the SEC. Matthew Solomon (Cleary Gottlieb Steen & Hamilton LLP) for Bradley Garlinghouse. Andrew J. Ceresney (Debevoise & Plimpton LLP) and Andrew Edward Goldsmith (Kellogg, Hansen, Todd, Figel & Frederick P.L.L.C.) for Ripple Labs Inc.

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