

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION— D.N.J.: Coinbase misled retail investors about regulatory and bankruptcy risk, (Sept. 9, 2024)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

Coinbase knew that customers faced risks if it entered bankruptcy protection, but it failed to disclose these risks to investors, even as it discussed other issues relating to asset security.

An amended class-action complaint sufficiently alleged that Coinbase misled investors by omitting to warn that their assets could become commingled in the event of bankruptcy and by downplaying the risk of the SEC bringing an enforcement action. Coinbase and the individual defendants knew that these risks existed and had a financial incentive to artificially inflate Coinbase's stock price, as demonstrated by their selling nearly \$1 billion worth of shares during the class period (*In re Coinbase Global, Inc. Securities Litigation*, No. 22-cv-04915 (D.N.J. Sept. 5, 2024)).

Alleged misrepresentations. The plaintiffs alleged that the defendants misled investors in three ways. First, Coinbase concealed the risk that in the event it filed for bankruptcy protection, the assets it held on behalf of customers could become part of the estate against which customers would have to file unsecured claims. Second, the defendants denied that Coinbase engaged in proprietary trading of crypto assets, which denials a *Wall Street Journal* article later revealed to be false. Finally, the defendants downplayed the likelihood that the SEC would bring an enforcement action.

The court determined that the first and last of these categories of misrepresentations were actionable. By discussing certain risks regarding the safeguarding of customers' assets, the defendants created a duty to disclose others. Furthermore, the defendants had a duty to disclose material facts related to the likelihood that the crypto assets Coinbase dealt in were securities.

However, the statements about proprietary trading were not actionable. The newspaper article was not detailed enough to meet the heightened pleading standard, was uncorroborated, and did not reflect an independent investigative effort.

Scienter. The plaintiffs also alleged scienter. Coinbase had submitted a comment letter to the SEC reflecting its understanding that institutional investors' assets could be jeopardized in the event of a bankruptcy, and it later conceded that it should have likewise tried to protect retail investors.

As for the regulatory statements, the plaintiffs alleged that the SEC informed the defendants of its position that "everything other than Bitcoin is a security." Despite knowing that an enforcement action was imminent, the defendants continued to downplay that risk.

The plaintiffs' allegations that the defendants were financially motivated to artificially inflate Coinbase's stock further contributed to a strong inference of scienter.

Loss causation. The plaintiffs adequately pleaded loss causation by drawing causal links between the challenged statements and their alleged losses. The Form 10-Q report that belatedly disclosed the potential consequences of a bankruptcy caused Coinbase's stock price to drop more than 26 percent, and the plaintiffs alleged multiple stock price drops connected to the misleading regulatory risk statements.

Section 11 claims. The court determined that the plaintiffs had standing to bring their Securities Act claims because they alleged that they purchased shares on the first day of Coinbase's direct listing at prices near the

opening price and that 88 percent of shares then outstanding were registered pursuant to the offering materials. This satisfied traceability.

Furthermore, the structure of the amended complaint, which clearly separated the claims under the '33 and '34 Acts, along with the express allegation of ordinary negligence as to the former, supported a finding that the Securities Act claim did not trigger the heightened pleading standard. Under the liberal notice requirements of Federal Rule of Civil Procedure 8, the Section 11 claims survived dismissal.

The case is [No. 22-cv-04915](#).

Judge: Martinotti, B.

Attorneys: James E. Cecchi (Carella, Byrne, Cecchi, Brody & Agnello, P.C.) for Sjunde AP-Fonden. Christopher L. Ayers (Seeger Weiss LLP) for Vijay Patel. Kevin M. McDonough (Latham & Watkins LLP) for Coinbase Global, Inc.

Companies: Sjunde AP-Fonden; Coinbase Global, Inc.

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