

## [Securities Regulation Daily Wrap Up, SECURITIES OFFERINGS—S.D.N.Y.: SEC slams crypto giant Ripple Labs and two execs with enforcement action over alleged \\$1.3B unregistered securities offering, \(Dec. 22, 2020\)](#)

Securities Regulation Daily Wrap Up

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The SEC alleges that Ripple and two executives failed for years to satisfy core investor protection provisions including securities registration and disclosures, and investors lacked key information as a result.

In an action likely to have far-reaching implications for digital asset offerings, the SEC brought an enforcement action against Ripple Labs, Inc. and two executives alleging that they raised over \$1.3 billion through an unregistered, ongoing digital asset securities offering. According to the SEC, Ripple raised the funds through the sale of XRP, a digital asset functioning as an investment contract, without filing a registration statement or satisfying an exemption from registration. The defendants also allegedly distributed billions of XRP in exchange for non-cash consideration, including labor and market-making services (*SEC v. Ripple Labs, Inc.*, December 22, 2020).

"Issuers seeking the benefits of a public offering, including access to retail investors, broad distribution and a secondary trading market, must comply with the federal securities laws that require registration of offerings unless an exemption from registration applies," [said](#) Stephanie Avakian, Director of the SEC's Enforcement Division.

**Ripple creates XRP.** According to the SEC, in late 2011 or early 2012, an individual identified only as "Co-Founder" began working on the idea and code for what would become the "XRP Ledger" (a/k/a "Ripple Protocol"). Among other functions, the XRP Ledger operates as a peer-to-peer database that records data about transactions. Co-Founder hired Christian Larsen as CEO of Ripple, as well as cryptographers and other individuals to perform the work. In December 2012, the XRP Ledger was completed and the final version was created of what today is a fixed supply of 100 billion XRP.

Prior to issuance of the XRP, two law firm memos in 2012 warned the defendants that there was some risk that XRP would be considered an "investment contract" (and thus a security) under the federal securities laws depending on various factors. Among other considerations, these included how Ripple promoted and marketed XRP to potential purchasers, the motivation of such purchasers, and Ripple's other activities with respect to XRP.

For example, if individuals purchased XRP to engage in speculative investment trading, or if Ripple employees promoted XRP as potentially increasing in price, the legal memos warned that Ripple would face an increased risk that XRP units would be considered investment contracts (and thus securities). The memos further warned that XRP was unlikely to be considered "currency" under the Exchange Act because, unlike "traditional currencies," XRP was not backed by a central government and was not legal tender.

**SEC alleges XRP is an unregistered security offering.** According to the complaint, XRP was a security throughout the offering and Ripple has engaged in an illegal securities offering from 2013 to the present.

The SEC argues that the following establish that XRP is a security:

- Defendants understood and acknowledged in non-public communications that the principal reason for anyone to buy XRP was to speculate on it as an investment;
- Starting in at least 2013 and through the offering, Defendants made statements in a variety of publicly available media promoting XRP as an investment into a common enterprise that included Ripple's

promises to undertake significant entrepreneurial and managerial efforts, including to create a liquid market for XRP, which would in turn increase demand for XRP and therefore its price.

The SEC contends that based on these representations, Ripple's actions, and the economic reality, XRP investors in the offering had a reasonable expectation of profiting from Ripple's efforts to deploy investor funds to create a use for XRP and bring demand and value to their common enterprise.

The SEC further argues that XRP are not "currency" under the federal securities laws. The SEC noted that Ripple has at times suggested that XRP are not securities, but instead exempt from the Securities Act altogether as "currencies." For example, in May 2015, Ripple and a subsidiary agreed to settle charges brought by the United States Department of Justice and FinCEN for failing to register as a "Money Services Business" under the Bank Secrecy Act, to comply with other regulatory requirements with respect to Ripple's XRP sales, which the settlement called "virtual currency."

But this does not hold up, the SEC argues. First, XRP has not been designated as legal tender in any jurisdiction. Second, Ripple has never offered or sold XRP as "currency," as that term is used in the federal securities laws. Instead, Ripple and its executives repeatedly publicly disclaimed that XRP was "currency" and tried to dissuade investors from thinking about XRP as "currency."

The SEC further alleged that the defendants failed to register the offering with the SEC and undertook significant efforts to monitor, manage, and impact the XRP trading markets, including the trading price and volume of XRP. These efforts included:

- Using algorithms to time the amount and price of Defendants' XRP sales into the market;
- Paying incentives to certain market makers—some of which Ripple engaged to effect the Market Sales—if the sales reached certain trading volume levels on XRP;
- Paying digital asset trading platforms to permit XRP trading;
- Timing the prices and amounts of XRP sales to achieve what Ripple viewed as desirable trading volume or price levels and fluctuations with respect to XRP.

Finally, the SEC asserted that in addition to the alleged unregistered \$1.3 billion securities offering, Larsen, the former CEO, and Bradley Garlinghouse, the company's current CEO, effected personal unregistered sales of XRP totaling approximately \$600 million.

"The registration requirements are designed to ensure that potential investors—including, importantly, retail investors—receive important information about an issuer's business operations and financial condition," said Marc P. Berger, Deputy Director of the SEC's Enforcement Division. "Here, we allege that Ripple and its executives failed over a period of years to satisfy these core investor protection provisions, and as a result investors lacked information to which they were entitled."

The complaint seeks injunctive relief, disgorgement with prejudgment interest, and civil penalties.

This is case [No. 20 Civ. 10832](#).

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