

## New Hampshire Federal Court Finds That Cryptocurrency was Issued in Violation of Securities Laws

The Law Of Banking, Articles / November 17, 2022 / Jeff Novel

As revelations regarding the collapse of the FTX Cryptocurrency Exchange come to light, the United States District Court for the District of New Hampshire has issued an [opinion](#) that hints at increased regulation of cryptocurrencies through securities laws.

On November 7, 2022, in *Securities Exchange Commission v. LBRY, Inc.*, the Court granted the Securities and Exchange Commission's ("SEC") motion for summary judgment against LBRY, Inc. ("LBRY"), a New Hampshire software company that issued a cryptocurrency known as "LBRY Credits" or "LBC." The Court ruled that LBRY offered and sold LBC in violation of federal securities laws because LBC was an investment contract under the test established by the United States Supreme Court in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

Under the Howey test, a transaction is an investment contract if:

1. It is an investment of money
2. The investment of money is in a common enterprise
3. There is an expectation of profits derived from the efforts of a promoter or third party

In evaluating whether LBC was a security, the U.S. District Court of the District of New Hampshire stated that only the third prong of the Howey test was in dispute. As a result, the court focused its analysis on whether LBRY's offerings of LBC led investors to have a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

In analyzing this issue, the Court found that LBRY published numerous statements that led potential investors to "reasonably expect that LBC would grow in value as the company continued to oversee the development of the LBRY Network" and determined that those statements satisfied the third prong of the Howey test. In particular, the Court noted that LBRY made the following representations:

- A blog post noting "that the long-term value proposition of LBRY is tremendous, but also dependent on our team staying focused on the task at hand: building this thing." The post further noted that "[o]ver the long-term, the interest of LBRY and the holders of [LBC] are aligned."
- An e-mail from LBRY's chief operating officer explaining that the "opportunity is obvious" and further stating, "buy a bunch of credits, put them away safely, and hope that in 1-3 years we've appreciated even 10% of how much Bitcoin has in the past few years."
- A Reddit post by LBRY's community manager explaining that the only way LBC will be "worth something in the future is if LBRY delivers on their promises to create a revolutionary way to share and monetize content."

- An interview in which LBRY's "Technology Evangelist" explaining how the future "value of LBRY credits" would depend on "the success of our media marketplace."

The Court further stated that these and other statements were "representative of LBRY's overall messaging about the growth potential for LBC" and such messaging amounted to "precisely the 'not-very-subtle' form of economic inducement" satisfying the third prong of the Howey test.

In an effort to avoid summary judgment, LBRY argued:

1. That it informed some potential purchasers of LBC that the company was not offering its token as an investment
2. That LBC is a utility token designed for use on the LBRY Blockchain
3. Some unknown number of purchasers acquired LBC with the intention of using it rather than holding it as an investment

In addressing these arguments, the Court stated that a disclaimer cannot undo the objective economic realities of a transaction, and nothing in the case law suggests that a token with both consumptive and speculative uses cannot be sold as an investment contract. Based on that analysis, the Court rejected LBRY's defenses and entered summary judgment in favor of the SEC. The damages to be awarded to the SEC will be determined at a later date, but it is seeking disgorgement of at least \$11 million relating to the sale of unauthorized securities.

The Court's ruling in *SEC v. LBRY* likely signals increasing regulation of cryptocurrencies by the SEC and indicates that a use case for a cryptocurrency is not enough to avoid classification as a security under the Howey test. Companies that use cryptocurrency as part of their business model need to understand this rapidly developing law and have counsel thoroughly analyze the compliance risks to avoid the dangers of issuing an unauthorized security.

Please contact the professionals in KRCL's Financial Services Practice Group if your business needs assistance analyzing these issues.

## Related Attorneys

---

Jeff Novel

## Related Practices

---

Financial Services