

Cryptocurrency ‘Regulation by Enforcement’ as Hot as Ever: What’s to come from Securities Regulators in 2024?

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Cryptocurrencies are becoming increasingly regulated under securities laws in Canada and the United States, often to the chagrin of those in control of crypto assets. In recent years, both Canadian and the U.S. regulators have made concerted efforts to definitively demonstrate that cryptocurrencies are under their purview and to accelerate aggressive enforcement proceedings. The crypto industry is mired in an indefinite and unenviable, and sometimes unknowable and often dangerous, game in Canada and the U.S., namely: regulation by enforcement, in the absence of legislation.

While the two countries often work together in cross-border investigations of crypto issuers and trading platforms, the timing of their regulatory changes and aggressiveness in enforcement actions have, at times, differed. Recent events and trends in the U.S. and Canada over the last year give some insight into what might be in store for cryptocurrency issuers and exchange platforms in 2024. Are regulators doubling down on ‘regulation by enforcement’, or are sunnier days ahead?

OSC Prioritizing Regulation of Crypto Trading Platforms

The Canadian Securities Administrators (“CSA”) have made the regulation of crypto assets a priority as crypto tokens and platforms have grown in the Canadian market over recent years. In September 2023, the CSA’s council members, comprised of provincial regulators including the Ontario Securities Commission (“OSC”), reported taking action in 16 crypto-related enforcement matters in the prior year, as well as issuing 422 alerts, cautions, and warnings related to crypto.^[1] The CSA also announced in 2023 that changes were being made to the standard pre-registration undertaking that unregistered crypto trading platforms were expected to enter into while they pursued securities registration. The CSA confirmed that “coordinated enforcement activities” would continue to identify non-compliant trading platforms and those failing to engage with the registration process.^[2]

For the OSC, its 2023 crypto enforcement activities included an investigation into Binance Holdings Ltd. (“**Binance**”), which is touted as the world’s largest crypto asset trading platform. Binance had previously, in March 2022, entered into an acknowledgement and undertaking with the OSC effectively agreeing to cease operating and wind up its crypto services within Ontario (the “**Undertaking**”).^[3] Binance specifically acknowledged that it had given incorrect information to its Ontario users and permitted Ontario users to continue trading on the Binance platform after restrictions were supposed to prevent such trade.^[4] The OSC expressly retained the right to bring enforcement proceedings against Binance in the future.^[5]

The OSC’s investigation into Binance was initiated by an order on May 10, 2023, on the basis that it appeared that Binance was circumventing its undertaking, trading and distributing securities without meeting the proper requirements including failure to comply with prospectus requirements, and making misleading statements to the OSC (the “**Investigation Order**”).^[6] In the two days that immediately followed, the OSC issued a summons requiring production of documents and information about Binance’s fees and earnings in Ontario (the “**Summons**”), and Binance announced that it would withdraw from operations in Canada.^[7]

In June 2023, Binance applied to the Capital Markets Tribunal (the “**Tribunal**”) asking it to revoke the Investigation Order. However, the Tribunal declined to revoke the Investigation Order on the basis that it did not have the jurisdiction to do so and explained in its reasons that the “commission” had the power to revoke the Investigation Order, whereas the Tribunal, though a division of the OSC, only had the power to revoke or vary its own decisions.^[8] Unsatisfied with the result at the Tribunal, Binance also applied to the Divisional Court for a judicial review of the Investigation Order and the Summons, alleging the Investigation Order was foreclosed by the Undertaking and that the Summons was overbroad. In September 2023, Justices McWatt, Stewart, and Matheson held that the Undertaking did not preclude the Investigation Order and that the Summons was not a breach of Binance’s section 8 *Charter*^[9] rights (highlighting the lower expectation of privacy within the securities context).^[10] In result, Binance remains subject to the Investigation Order and Summons.

Notably, Binance’s legal troubles in Ontario are not limited to the OSC’s enforcement activities. Binance is also facing a proposed class action seeking rescission or damages against Binance for selling securities without filing or delivering a prospectus. The proposed class includes everyone in Canada who purchased crypto derivatives contracts from Binance since September 2019.^[11] While this action is still in its early stages, the plaintiffs recently defeated Binance’s attempt to have the action stayed in favour of an arbitration clause. In December 2023, Justice E.M. Morgan held that the arbitration agreement contained within the terms and conditions on Binance’s website was unenforceable based on the grounds of public policy and unconscionability.^[12]

SEC Continues Crackdown on Crypto

While the CSA and OSC have made crypto regulations a clear priority, the U.S. Securities and Exchange Commission (“**SEC**”) has pursued an increasingly aggressive enforcement policy in the cryptocurrency space, seeking to capture tokens and exchanges under the SEC’s jurisdiction. This increase in enforcement has been apparent since SEC Chair, Gary Gensler, took on the SEC’s top role in 2021. In the SEC’s past fiscal year, the SEC reported a record 784 enforcement actions, of which many were focused specifically on crypto fraud schemes, unregistered crypto asset offerings, and unregistered crypto platforms and intermediaries. The SEC also brought proceedings and charges against celebrities who endorsed crypto assets without disclosing that they had been compensated to do so.^[13] The SEC and Chair Gensler were sending a clear message on how the regulators were going to handle the gap in legislation until it was addressed by Congress: enforcement proceedings of all shapes and sizes, targeting players big and small.

Amongst the highest profile actions against crypto platforms, was the SEC filing of 13 charges against Binance and its founder in June 2023.^[14] The charges included the alleged offering of exchange, broker-dealer, and clearing agencies services without registering with the SEC, offers and sales of unregistered crypto assets, and misrepresentations to investors of the controls in place at Binance.^[15] These charges were laid less than a month after the OSC issued the Investigation Order. In September 2023, Binance and its founder filed a motion seeking to dismiss the SEC’s charges on numerous bases, including that the SEC has proceeded on the flawed argument that tokens are securities. Binance and its founder argued in a joint filing that the SEC had attempted “to regulate this trillion-dollar [crypto] industry through enforcement rather than rulemaking”.^[16] The motion to dismiss was heard by Judge Amy Berman Jackson on January 22, 2024, but her decision remains under reserve. Some reporting from the oral arguments suggests that “the general tone of the proceedings” seemed to lean in the SEC’s favour and that the action would likely progress to trial.^[17]

In June 2023, the SEC also charged Coinbase Inc. and Coinbase Global Inc. (collectively “**Coinbase**”), the largest crypto asset trading platform in the U.S., for allegedly operating as an unregistered securities exchange, broker, and clearing agency through its crypto asset trading platform.^[18] The SEC further charged Coinbase with “failing to register the offer and sale” of its crypto asset staking-as-a-service-program, which pools assets to verify blockchain network activity and takes commissions in exchange for rewards.^[19] Coinbase brought a motion to dismiss the SEC’s action, which proceeded to oral arguments before Judge Katherine Polk Failla on January 17, 2024. Reports from the hearing suggest that Coinbase argued that the SEC was advancing an expansive definition and that Judge Failla expressed concern that the SEC’s position could result in collectibles, such as beanie babies, being captured by securities regulations.^[20] Judge Failla is expected to release a decision in the coming weeks.

Are Public Crypto Exchanges Regulated by U.S. Securities Laws?

Whether crypto tokens are or are not securities within the SEC's regulatory purview is an ongoing debate that was recently tested within an SEC action against Ripple Labs, Inc ("Ripple")^[21] and its two senior leaders (including CEO Brad Garlinghouse). In a 2020 action commenced in the Southern District of New York, the SEC alleged that Ripple raised \$1.3 billion through Ripple's offering of its native digital token, XRP.^[22] In July 2023, the SEC and Ripple brought competing summary judgment motions, which in result left both parties with partial success (though further issues in the action remained to be tried).^[23] The main issue on summary judgment was whether Ripple had offered to sell XRP as a security and particularly as an investment contract.^[24]

Judge Analisa Torres held that the XRP digital token was not a security when sold on exchanges to the public in the context of this case but was a security when sold to institutional investors under different factual circumstances. Her decision relied on the "investment contract" test from *Howey*,^[25] which provides that a transaction will be considered an investment contract (thus a security) where a person:

1. invests their money;
2. in a common enterprise; and
3. had an expectation of profits derived solely from the efforts of the promoter or others.^[26]

In applying the *Howey* test, Judge Torres concluded that Ripple had engaged in the unregistered offer and sale of investment contracts with respect to their "institutional sales". The Court found the definition of a security was met through the *Howey* test where institutional buyers, hedge funds, and customers using Ripple's on-demand liquidity feature purchased XRP through direct sales contracts.^[27]

However, Judge Torres partially found in favour of Ripple concluding that, in the totality of circumstances of this case, XRP sales through trading algorithms and digital asset exchanges (i.e. "programmatic sales") did not constitute offers and sales of investment contracts because buyers could not reasonably expect profit (or value increases) from Ripple's efforts.^[28] Rather, the Court highlighted that the programmatic sales were blind bids where the buyers were "in the same shoes as a secondary market purchaser who did not know to whom or what it was paying its money."^[29] Further, Judge Torres found that XRP tokens given to employees and third parties as a form of payment for services or under written contracts (i.e. "other distributions") were not securities as there was no "investment of money" in the transactions.^[30]

Notably, the SEC attempted to appeal in October 2023, asking Judge Torres to certify an interlocutory appeal of the findings that programmatic sales and other distributions of XRP tokens were not securities.^[31] The SEC argued that another recent crypto decision, *SEC v. Terraform Labs*,^[32] conflicted with the finding that sales over crypto asset trading platforms (the programmatic sales) could not give rise to an investment contract. Judge Torres disagreed and dismissed the motion for certification, highlighting that the *Ripple* decision did not turn on the fact that programmatic sales were sold through exchanges to retail investors but rather on the expectations those retail investors had about earning profit from Ripple's efforts.^[33]

Trial of the remaining issues in the *SEC v. Ripple* case is set to begin in April 2024.^[34] In the meantime, Mr. Garlinghouse appears to be pushing back against the SEC's ongoing proceedings against Ripple in the media. Reports from January 2024 quote Mr. Garlinghouse as calling the SEC "a very hostile regulator" of crypto and Chair Gensler as a "political liability".^[35] Decisions on the motions to dismiss in *SEC v. Binance* and *SEC v. Coinbase*, described above, are also expected to be released in the coming months and will likely test the *Howey* analyses applied in *SEC v. Ripple* and *SEC v. Terraform Labs* further.

Implications for Canadian Crypto Tokens and Trading Platforms

Canada relies on the analysis from *Pacific Coast Coin Exchange of Canada Ltd. v. Ontario (Securities Commission)*^[36] – similar to the *Howey* test – to determine if a transaction constitutes an investment contract and is thus a security. The *Pacific* test asks whether there has been:

1. an investment of money;
2. with an intention or an expectation of profit;
3. in a common enterprise where the success or failure of the enterprise is interwoven and dependent on the efforts of a person other than the investor; and
4. efforts made by those others significantly affect the success or failure of the enterprise.^[37]

The CSA has long taken the position that *many* initial crypto coin offerings are investment contracts and therefore securities within the CSA's regulatory purview, but has highlighted that each instance must be analyzed on a case-by-case basis relying on the *Pacific* test.^[38]

It remains to be seen whether the *Ripple* decision, or arguments based on its analysis of public crypto trading platforms, will come up in the Canadian context to challenge regulatory enforcement. The outcomes of the motions to strike by Binance and Coinbase are also likely to impact the feasibility of Canadian crypto asset holders advancing a *Ripple*-type argument.

With the CSA's commitment to "strengthen oversight and enforcement in the crypto asset sector" for 2024-2025,^[39] we expect to see a greater number of cases enforcing Canadian securities regulations against crypto tokens and trading platforms regardless of how the American courts decide to treat similar crypto assets in the U.S. The absence of clear guidance or legislation on crypto in the U.S. has led to an indefinite game of cat and mouse through enforcement proceedings (mostly, cat). It seems inevitable that the crypto industry in Canada will continue to follow suit with an even greater number of enforcement cases, growing the pressure of regulation by enforcement until legislators step in to fill the gap.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

^[1] Canadian Securities Administrators, *CSA Year in Review 2022-2023*, (September 6, 2023) online: <<https://www.securities-administrators.ca/wp-content/uploads/2023/09/CSA-YearInReview-Sept-6.pdf>> at p 6.

^[2] *Ibid*, p 24-25.

^[3] "Binance Undertaking and Acknowledgement," (March 16, 2022), online (pdf): *Ontario Securities Commission*, <<https://www.osc.ca/sites/default/files/2022-03/20220316-Binance-Undertaking-and-Acknowledgement.pdf>> [*Undertaking*].

^[4] *Binance Holdings Limited v. Ontario Securities Commission*, [2023 ONSC 4541 \(CanLII\)](#), at para 10, [*Binance v. OSC*].

^[5] *Undertaking*, *supra* note 3 at p 6.

[6] *Binance v. OSC*, *supra* note 4 at para 17.

[7] *Binance v. OSC*, *supra* note 4 at para 18.

[8] *Binance Holdings Limited (Re)*, 2023 ONCMT 27.

[9] *The Constitution Act*, 1982, Schedule B to the *Canada Act 1982 (UK)*, 1982, c 11, s 8.

[10] *Binance v. OSC*, *supra* note 4 at paras 44 and 58.

[11] *Lochan v. Binance Holdings Limited*, 2023 ONSC 6714 para 12.

[12] *Ibid.*

[13] Securities and Exchange Commission, “Press Release: SEC Announces Enforcement Results for Fiscal Year 2023”, (November 14, 2023), online: *Securities and Exchange Commission* <<https://www.sec.gov/news/press-release/2023-234>>; Securities and Exchange Commission, “Spotlight: Crypto Assets and Cyber Enforcement Actions” (December 11, 2023) online: *Securities and Exchange Commission* <<https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>>.

[14] Securities and Exchange Commission, “Press Release: SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao”, (June 5, 2023), online: *Securities and Exchange Commission* <<https://www.sec.gov/news/press-release/2023-101>>.

[15] *Securities and Exchange Commission v. Binance Holdings Limited et al.*, Complaint, 1:23-cv-01599, (S.D.N.Y., filed June 5, 2023).

[16] *Securities and Exchange Commission v. Binance Holdings Limited et al.*, Joint Motion to Dismiss Claim, 1:23-cv-01599-ABJ-ZMF (S.D.N.Y., filed September 21, 2023).

[17] Steven Stradbroke, “Judge not wowed by Binance’s ‘no one told us this was illegal’ arguments” (January 24, 2024), online: *CoinGeek* <<https://coingeek.com/judge-not-wowed-by-binance-no-one-told-us-this-was-illegal-arguments/>>.

[18] Securities and Exchange Commission, “Press Release: SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency”, (June 6, 2023) online: *Securities and Exchange Commission* <<https://www.sec.gov/news/press-release/2023-102>>.

[19] *Ibid.*

[20] Chris Dolmetsch, “Coinbase Compares Buying Crypto to Collecting Beanie Babies” (January 17, 2024) online: *Bloomberg* <<https://www.bloomberg.com/news/articles/2024-01-17/coinbase-argues-crypto-like-beanie-babies-in-sec-case-hearing>>.

[21] Ripple is one of the largest cryptocurrency platforms by market capitalization and is responsible for developing and maintaining the XRP ledger network on which XRP operates. The XRP ledger – or blockchain – is secured cryptographically with key pairs. Transactions are authorized by private key holders. It is a quorum-based consensus model (Ripple Protocol Consensus Algorithm), which allows a majority of validators to agree on transactions occurring on the ledger.

[22] *SEC v. Ripple Labs Inc.*, Complaint, 20-cv-10832, (S.D.N.Y., filed December 22, 2020).

[23] SEC v. *Ripple Labs, Inc.*, Order, [20-cv-10832-AT-SN](#), (S.D.N.Y., filed July 13, 2023) [**Ripple Labs Order**].

[24] *Ibid* at p 10.

[25] SEC v. *W.J. Howey Co.*, [328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 \(1946\)](#) [**Howey**].

[26] *Ibid*.

[27] *Ripple Labs Order*, *supra* note 23 at p 4, 22-25.

[28] *Ripple Labs Order*, *supra* note 23 at p 4, 22-25.

[29] *Ibid*, at p 23.

[30] *Ibid*, at p 4-5, 26-27.

[31] SEC v. *Ripple Labs Inc.*, Order – Interlocutory Appeal, [20-cv-10832-AT-SN](#), (S.D.N.Y. filed October 3, 2023) [**Ripple Labs Order – IA**].

[32] SEC v. *Terraform Labs Pte Ltd et al*, [Opinion and Order from Motion to Dismiss](#), 23-cv-01346-JSR, (S.D.N.Y filed July 31, 2023) at p 40. The SEC was subsequently successful in a partial summary judgment motion, where it was held that a number of Terraform's crypto assets constituted securities as there was "no genuine dispute that the elements of the Howey test" had been met; SEC v. *Terraform Labs Pte Ltd et al*, [Opinion and Order from Summary Judgment Motion](#), 23-cv-01346-JSR, (S.D.N.Y filed December 28, 2023).

[33] *Ripple Labs Order – IA*, *supra* note 31.

[34] *Ibid*.

[35] Arjun Kharpal, "Crypto firm Ripple explored IPO outside of U.S. because of 'hostile' SEC, won't go public soon" (January 16, 2024), online: *Money Report, CNBC* <<https://www.nbcnewyork.com/news/business/money-report/crypto-firm-ripple-explored-ipo-outside-of-u-s-because-of-hostile-sec-wont-go-public-soon/5045763/>>.

[36] *Pacific Coast Coin Exchange of Canada Ltd. v Ontario (Securities Commission)*, [\(1977\) S.C.J. No. 117, \(1978\) 2 S.C.R. 112 \(SCC\)](#) [**Pacific Coast Coin**].

[37] *Ibid*.

[38] CSA Staff Notice 46-307 *Cryptocurrency Offerings*, (August 24, 2017) online: CSA <https://www.osc.ca/sites/default/files/pdfs/irps/csa_20170824_cryptocurrency-offerings.pdf>; CSA Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens*, (June 11, 2018) online: CSA <https://www.osc.ca/sites/default/files/pdfs/irps/csa_20180611_46-308_implications-for-offerings-of-tokens.pdf>.

[39] Ontario Securities Commission, OSC Notice 11-798 – *Statement of Priorities*, (November 16, 2023) online: (pdf) OSC <https://www.osc.ca/sites/default/files/2023-11/20231116_11-798_statement-of-priorities-2024-2025_EN.pdf> at p 15.

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