

ALERT • JUNE 13, 2023

# SEC Sues Binance and Coinbase: What Are the Allegations and What Is Next?

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In the span of two days, June 5 and June 6, 2023, the US Securities and Exchange Commission (**SEC**) commenced proceedings against the largest crypto asset exchange in the world, Binance.com; its affiliated US exchange, Binance.US; and the largest crypto asset exchange in the US, Coinbase, a public company listed on Nasdaq. In each case, the SEC alleged violations of the Securities Act of 1933 (the **Securities Act**) and the Securities Exchange Act of 1934 (the **Exchange Act**), most significantly for operating unregistered trading platforms. While not unexpected in both cases in light of (i) the Commodity Futures Trading Commission's March 2023 action against Binance,<sup>1</sup> and (ii) Coinbase's well-publicized receipt of and response to an SEC Wells Notice, the actions are nonetheless alarming to the industry. Below we summarize the allegations contained in the respective complaints, the relief sought, related litigation and developments, and what to expect next as litigation proceeds.

## *SEC v. Binance Holdings Limited et al.*

On June 5, 2023, the SEC filed a complaint in the District of Columbia (the **Binance Complaint**) against Binance Holdings Limited (**Binance**), BAM Trading Services Inc. (**BAM Trading**), BAM Management US Holdings Inc. (**BAM Management**), and Binance founder Changpeng Zhao (**CZ**) in connection with both the Binance.com trading platform and the Binance.US trading platform as follows.<sup>2</sup>

## Allegations

The SEC alleges a number of registration violations under the Exchange Act with respect to both the Binance.com and Binance.US trading platforms. In particular:

- **Binance.com.** The SEC alleges that the Binance.com trading platform was an unregistered broker, an unregistered exchange, and an unregistered clearing agency. In this regard, the SEC alleges that Binance provided securities brokerage, exchange, and clearing services to US customers, without necessary licenses and registrations, all while publicly claiming that US customers were restricted from trading on the Binance.com trading platform.
- **Binance.US.** The SEC alleges that, with respect to the Binance.US trading platform, (i) BAM Trading violated the Exchange Act by acting as an unregistered broker and (ii) Binance and BAM Trading violated the Exchange Act by acting as an unregistered exchange and unregistered clearing agency. In this regard, the SEC alleges that the Binance.US trading platform operated using matching engine software, digital wallet, clearing and settlement technology, and other technology and software licensed from Binance.

The SEC further alleges in the Binance Complaint that the following crypto assets supported by Binance.com and/or Binance.US have been offered and sold as investment contracts and thus securities under the SEC's interpretation of the *Howey* test: SOL, ADA, MATIC, FIL, ATOM, SAND, MANA, ALGO, AXS, and COTI.

The SEC further alleges, pursuant to Section 20(a) of the Exchange Act, that CZ is personally liable for the foregoing alleged Exchange Act violations as a control person of Binance, with respect to the Binance.com trading platform allegations, and as a control person of Binance and BAM Trading, with respect to the Binance.US trading platform allegations.

Separate from the alleged Exchange Act violations above, the Binance Complaint alleges that the Binance defendants engaged in unregistered securities offerings in violation of the Securities Act. In particular:

- *BNB Token*. The SEC alleges that BNB token is a "crypto asset security" that Binance offered and sold on an unregistered basis dating back to its 2017 initial coin offering because Binance touted an investment in BNB as an investment in Binance's efforts to create a successful crypto asset trading platform centered on BNB.
- *BUSD Stablecoin*. In addition, the SEC alleges that Binance has offered and sold BUSD, a Binance-branded USD stablecoin launched with a New York trust company partner pursuant to a stablecoin-as-a-service agreement, as an unregistered securities offering under a *Howey* investment contract analysis. In this regard, the SEC's allegations focus not only on the
- *BUSD stablecoin* itself but on an alleged common enterprise and profit-making opportunities in the form of a broader alleged BUSD "ecosystem," including various BUSD rewards and earn programs.
- *BNB Vault and Earn Program*. The SEC also alleges that Binance engaged in the unregistered offer and sale of investment contracts, dubbed "crypto asset securities" by the SEC in the complaint, in connection with its BNB Vault and Earn Program. As alleged by the SEC, these programs allowed holders of BNB and other crypto assets to earn interest and profit by lending their crypto assets to Binance.
- *Binance.US Staking Program*. The SEC also alleges that Binance.US's staking programs constituted unregistered offers and sales of investment contracts.

Finally, the SEC alleges that, in connection with the Binance.US trading platform, BAM Trading and its holding company BAM Management committed at least negligence-based fraud by engaging in acts and practices that operated as a fraud and deceit on, and/or obtained money or property based on false and misleading statements to, Binance.US customers and equity investors in BAM Management. In particular, the SEC alleges that BAM Trading and BAM Management misled Binance.US customers and equity investors concerning the existence and adequacy of market surveillance and controls to detect and prevent manipulative trading such as wash trading. In this regard, the SEC alleges that certain Binance- and CZ-affiliated entities and accounts engaged in wash trading on the Binance.US trading platform.

## Relief Sought

The SEC is seeking relief permanently enjoining (i) Binance, BAM Trading, and CZ from further Exchange Act violations by continuing to act as an unregistered broker, unregistered exchange, and unregistered clearing agency; (ii) Binance and BAM Trading from further violations of the Securities Act by continuing to engage in unregistered securities offerings; and (iii) BAM Trading and BAM Management from further misleading and deceptive conduct in violation of the charged provisions of the Securities Act. In addition, the SEC is seeking disgorgement of all ill-gotten gains from the foregoing alleged Exchange Act and Securities Act violations, as well as civil monetary penalties against each defendant to the Binance Complaint. Significantly, despite the lack of allegations regarding scienter-based violations (i.e., those committed either knowingly or recklessly), the SEC is also seeking pursuant to the court's "equitable" authority to permanently bar CZ from acting as an officer or director of any SEC-reporting company or issuer of SEC-registered securities.

## SEC Files Motion for Temporary Restraining Order

On June 6, 2023, the day after filing the Binance Complaint, the SEC filed an emergency action in the case seeking, among other relief, a temporary restraining order freezing the assets of BAM Management and directing the repatriation of all assets held for the benefit of customers of the Binance.US trading platform.<sup>3</sup> The SEC also seeks other emergency relief, including orders prohibiting the destruction of records, requiring sworn accountings of certain assets, and for expedited discovery and alternative service.

## *SEC v. Coinbase, Inc. and Coinbase Global, Inc.*

On June 6, 2023, the SEC filed a complaint in the Southern District of New York against Coinbase, Inc. (**Coinbase**), and Coinbase Global, Inc. (**CGI**), alleging a number of violations of the US federal securities laws (the **Coinbase Complaint**),<sup>4</sup> as summarized below.

## Allegations

The SEC alleges in the Coinbase Complaint that, in operating the core Coinbase trading platform, Coinbase violated the Exchange Act and has acted as an unregistered broker, an unregistered exchange, and an unregistered clearing agency. With respect to clearing agency status in particular, the SEC alleges that, among other things, Coinbase served as an intermediary in settling transactions and created a system for the central handling of securities whereby securities deposited and traded on the Coinbase Platform were treated as fungible and customer accounts were debited and credited by Coinbase to settle customers' transactions.

In addition, the Coinbase Complaint alleges that Coinbase operated as an unregistered broker and thereby violated the Exchange Act through two other services:

- *Coinbase Prime*. The SEC alleges that Coinbase has operated as an unregistered broker through its Coinbase Prime offering, described as a prime brokerage service allowing institutional customers to route crypto asset orders to the Coinbase trading platform and other third-party trading venues.
- *Coinbase Wallet*. The SEC alleges that Coinbase has also operated as an unregistered broker by offering the Coinbase Wallet, which allows users to connect to decentralized exchanges and non-Coinbase trading venues. Notably, Coinbase Wallet is a self-custody wallet through which users hold and manage their own private keys and crypto asset holdings.

The SEC alleges, pursuant to Section 20(a) of the Exchange Act, that CGI is liable for the foregoing alleged Exchange Act violations by virtue of having exercised power and control over Coinbase, including by managing and directing such wholly owned subsidiary and by directing and participating in the acts constituting Coinbase's Exchange Act violations.

In connection with the foregoing, the Coinbase Complaint alleges that the following crypto assets supported by Coinbase are offered and sold as investment contracts and thus securities under the SEC's interpretation of the Howey test: SOL, ADA, MATIC, FIL, SAND, AXS, CHZ, FLOW, ICP, NEAR, VGX, DASH, and NEXO.

Separately, the SEC alleges in the Coinbase Complaint that Coinbase violated the Securities Act and engaged in unregistered securities offerings without qualifying for an applicable exemption from registration through its offer and sale of Coinbase's staking program. In this regard, the SEC alleges that the Coinbase staking program as it applies to five crypto assets — XTZ, ATOM, ETH, ADA, and SOL — involves the offer or sale of an investment contract under *Howey analysis*.

## Relief Sought

By the Coinbase Complaint, the SEC is seeking relief permanently enjoining (i) Coinbase and CGI from further violations of the charged provisions of the Exchange Act; and (ii) Coinbase from further violations of the charged provision of the Securities Act.

In addition, the SEC is seeking disgorgement of all ill-gotten gains from the foregoing alleged Exchange Act and Securities Act violations, as well as civil monetary penalties against each of Coinbase and CGI. Unlike in the Binance Complaint, no individuals

are defendants to the Coinbase Complaint, and the SEC does not seek any officer or director bars.

## Related Litigation and Developments

An important and interesting additional complexity to the SEC's suit against Coinbase is Coinbase's own pending administrative law suit against the SEC in the Third Circuit. As has been widely publicized, in April 2023, Coinbase commenced proceedings petitioning for a writ of mandamus compelling the SEC to respond to Coinbase's July 2022 petition for the SEC to propose new rules governing the offer, sale, registration, and trading of digital asset securities.<sup>5</sup> On June 6, 2023, referencing the SEC's commencement of proceedings against Coinbase earlier the same day without having responded to Coinbase's petition for a rulemaking, Judge Cheryl Ann Krause of the Third Circuit ordered the SEC to confirm to the court whether it has now determined to deny the rulemaking petition or else why the court should not require the SEC to submit periodic reports on its progress or impose a deadline for the SEC to make its determination.

On the same day the SEC filed the Coinbase Complaint, the Alabama Securities Commission announced that it had issued a show cause order alleging that Coinbase's staking program constitutes an unregistered securities offering in Alabama. Coinbase and CGI reportedly have 28 days to show cause why a cease and desist order should not follow.<sup>6</sup> In announcing the show cause order, the Alabama Securities Commission described its action as resulting from a multistate task force spanning securities regulators from Alabama, California, Kentucky, Illinois, Maryland, New Jersey, South Carolina, Vermont, Washington, and Wisconsin.

## What to Expect Next

The SEC's filing of the Binance Complaint and Coinbase Complaint mark the very beginning of what will likely be lengthy litigation with the respective defendants. Coinbase in particular has been very public with its ongoing disagreements with the SEC and its intention to fully litigate this matter.

With respect to the Coinbase Complaint, Coinbase and CGI have each waived formal service by the SEC. As a result, the Coinbase parties will now technically have 60 days from June 7 to file a motion to dismiss or answer to the complaint. A motion to dismiss is likely to come first, and the parties will almost certainly negotiate a longer briefing schedule. Thus, the SEC's response in opposition to any such motion to dismiss and Coinbase's following reply will likely stretch into the end of 2023.

Next steps with respect to the Binance Complaint will be coming more quickly, given the SEC's filing of the motion for a temporary restraining order, and will implicate additional considerations, including potential disputes concerning service on the non-US defendants.

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<sup>[1]</sup> CFTC Press Release, CFTC Charges Binance and Its Founder, Changpeng Zhao, with Willful Evasion of Federal Law and Operating an Illegal Digital Asset Derivatives Exchange (Mar. 27, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8680-23>.

<sup>[2]</sup> SEC Press Release, SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (Jun. 5, 2023), <https://www.sec.gov/news/press-release/2023-101>.

<sup>[3]</sup> SEC Press Release, SEC Seeks Emergency Relief to Ensure Binance.US Customers' Assets are Protected (Jun. 6, 2023), <https://www.sec.gov/news/press-release/2023-103>

<sup>[4]</sup> SEC Press Release, SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency (Jun. 6, 2023), <https://www.sec.gov/news/press-release/2023-102>.

<sup>[5]</sup> *In re Coinbase, Inc.*, No. 23-1779 (3rd Cir.).

<sup>[6]</sup> Alabama Securities Commission News Release, Alabama Securities Commission Issues Show Cause Order to Crypto Asset Company Coinbase (Jun. 6, 2023), [https://asc.alabama.gov/News/2023%20News/6-6-2023\\_Coinbase.pdf](https://asc.alabama.gov/News/2023%20News/6-6-2023_Coinbase.pdf).

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