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The SEC Said 'Hashlets' Were a Security. This Federal Jury Disagrees.

On Monday, a federal jury in Hartford, Connecticut found that four separate crypto assets were not securities in what appears to be the first time jurors in the Second Circuit, if not the whole country, were asked to consider whether a particular cryptocurrency was a security or not.

By Ross Todd
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As I've written before, the question at the heart of a lot of legal disputes springing out of the cryptocurrency world is whether or not a particular cryptocurrency asset is a security.

This week, for what appears to be the first time in the Second Circuit if not the whole country, that question was put in the hands of a federal jury.

On Monday, a nine-person jury in Hartford, Connecticut found that four separate cryptocurrency-related assets — Hashlets, Hashstakers, Hashpoints and PayCoin — were not securities.

That was welcome news for defense lawyers at **Hughes Hubbard & Reed** and their client Stuart Fraser, the former vice-chair of financial services firm Cantor Fitzgerald. During an eight-day liability trial last month, Fraser faced state and federal securities claims brought by a class of investors represented by counsel at **Susman Godfrey**. Plaintiffs claimed they lost tens of millions of dollars investing in the products sold in the middle of the past decade by two cryptocurrency mining companies founded by Homero Joshua Garza, a protégé of Fraser's who pleaded guilty to fraud in 2017. Garza marketed the products as a way for investors to profit from his companies' efforts to buy up computing power to mine cryptocurrency.

Courtesy photo

Dan Weiner of Hughes Hubbard & Reed.

But according to federal prosecutors, the companies had little if any large-scale cryptocurrency mining power, and they used new investor funds to pay off old investors. Garza was sentenced to 21 months in prison in 2018 and ordered to pay $9.1 million in restitution.

The Litigation Daily caught up with Fraser's lead defense lawyer **Daniel Weiner**, the co-chair of the litigation department at Hughes Hubbard, Tuesday to discuss how the complex question of whether Hashlets, Hashstakers, Hashpoints and PayCoin are securities ended up with the jury. Weiner said at the close of the plaintiffs' case, he and his colleagues actually made a Rule 50 motion asking the judge to find the four products were not securities. But with the plaintiffs arguing the question should go to the jury, the judge waited to weigh in himself.

The jury instructions baked in the so-called *Howey* test, the multifactor test named after a 70-year-old U.S. Supreme Court case concerning shares and service contracts in citrus groves which lays out the definition of what's an "investment contract" subject to U.S. securities laws. On that front, Weiner said that it was key to establish that the investors retained some control over their investments to establish the underlying assets didn't fulfill the third-prong of the test, that profits "be derived solely from the efforts of others."

"We got testimony from one of the two of the plaintiffs saying 'I got up every morning and I could redirect my investment from one mining pool to another pool, and I could boost the gain on it.'" Weiner said. He said it wasn't "the picture of a passive investor" like you might see with someone who invests in a company and then waits to see how it performs. One factor weighing against Fraser, though, was the civil fraud case the SEC brought against Garza and the companies in 2015. The SEC's complaint labeled at least one of the underlying assets, Hashlets, as "investment contracts."

"I think the plaintiffs were pretty confident that if the Securities Exchange Commission says 'it's a security,' who is the jury to go against them?" Weiner said. "But I guess the jury saw otherwise."

The plaintiffs' counsel, **Seth Ard** and **Jacob Buchdahl** of Susman Godfrey, didn't immediately respond to messages Tuesday.

Had jurors found that the underlying assets were securities, they would have then proceeded to the question of whether Fraser acted as a control person for the companies, which he had also invested in, losing $12 million, according to Weiner. Weiner says the evidence showed that every time Fraser offered Garza advice, Garza blew him off. "It's called control personal liability. It's not called advice person liability, or minority investor liability or friend liability," Weiner said. "What kind of criminal mastermind behind the scenes loses $12 million?"

Now that's a good question.

Hughes Hubbard & Reed