

CLIENT ALERT

SEC's Focus On DeFi Is Made Clear Through Its Suit Against LBRY, Inc.

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On March 29, 2021, the U.S. Securities and Exchange Commission filed a complaint against LBRY, Inc., a decentralized blockchain company that operates a content sharing application. The SEC alleges that starting in 2016 and continuing through the present, LBRY sold more than 13 million digital asset securities called LBRY Credits to investors (some in the U.S.) in exchange for U.S. dollars, bitcoins, and other consideration. The SEC claims that LBRY Credits constitute investment contracts under the *Howey Test*, which LBRY failed to register as securities in violation of Sections 5(a) and 5(c) of the Securities Act of 1933. This appears to be the first Section 5 case against an issuer of a token on a decentralized platform, signaling the SEC's focus on decentralized finance, or DeFi.

In its complaint, the SEC claims that LBRY Credits are nothing more than investment contracts: individuals and entities purchased LBRY Credits for U.S. dollars, bitcoins, and other consideration; LBRY Credit holders invested in a common enterprise; and LBRY Credit holders expected a profit from LBRY's efforts. The SEC also claims that the LBRY Network may not be as decentralized as LBRY claims, arguing that:

- LBRY maintains managerial and entrepreneurial control over the LBRY Network;
- LBRY continues to control its software code for its applications and the protocol;
- LBRY continues to unilaterally make strategic and managerial decisions about the future of the LBRY Network; and
- LBRY continues to unilaterally decide how to allocate the capital and resources it has pooled from investors to grow the Network.

Shortly after the SEC filed its complaint, LBRY launched a website called "[Help LBRY Save Crypto](#)" in which it tells its side of the story. LBRY counters the SEC's "no decentralization" claims, stating that "even if LBRY, Inc., is shut down by the SEC as a result of this litigation, the LBRY network will continue to function and grow through the effort of the distributed LBRY community."

Key Takeaways

- The SEC continues enforcement initiatives against what it perceives to be unregistered sales of securities by digital asset companies under the new Biden Administration;
- The relevant sales in this case date back to 2016 which serves as a reminder to the industry of the SEC's five-year statute of limitations during which it can bring a case against those that it deems to have violated its rules or regulations; and
- The SEC may seek to extend its statute of limitations to bring cases such as this one by, as it does in this case, claiming that the various offerings throughout a prolonged period of time are part of "one continuous (or in the alternative, an integrated) offering of securities."

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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