

## Why Celebrities Are Ensnared In SEC Crypto-Touting Actions

By **Kurt Gottschall** and **Payton Roberts** (March 1, 2023, 3:08 PM EST)

On Feb. 17, the U.S. Securities and Exchange Commission charged former Boston Celtics star Paul Pierce with unlawfully touting crypto-asset EthereumMax, or EMAX.[1] Pierce settled, in part, by paying \$240,000 in disgorgement and a \$1.1 million penalty, also agreeing to not promote crypto-assets for the next three years.

The SEC alleged that Pierce violated the anti-touting provision of the federal securities laws by posting favorable reviews of EMAX tokens on Twitter in exchange for EMAX tokens worth approximately \$244,000.[2]

The settled order depicts screenshots of Pierce's tweets, with one particular tweet illustrating a trading account showing about \$2.5 million worth of EMAX up 83% on the day.

The commission also accused Pierce of misleading investors by claiming that he owned EMAX for a month when he had only received EMAX tokens two days prior.

The SEC's case against Pierce is the latest in a steady stream of crypto-touting cases. So why do celebrities keep getting snared?

### The Anti-Touting Provision

Section 17(b) of the Securities Act of 1933 — the anti-touting provision — makes it unlawful "to publish, give publicity to, or circulate any ... communication" that "describes such security for a consideration received or to be received ... without fully disclosing the receipt ... of such consideration and the amount thereof." [3]

Under the anti-touting provision, consideration received includes shares of the security being promoted.[4]

Historically, the bulk of the SEC's enforcement of the anti-touting provision involves promoters of microcap securities, but over the past five years, with the continued growth of social media and the explosive growth of crypto-assets, the commission has focused on anti-touting cases against crypto promoters, including numerous celebrities.

### The Evolving Landscape of Crypto-Assets as Securities

In July 2017, the SEC's seminal report of investigation concerning The DAO, called The DAO Report, warned that certain virtual tokens or coins sold in initial coin offerings, or ICOs, may be securities, and thus their offer and sale would be subject to the registration provisions of the federal securities laws.[5]

Following The DAO Report, the SEC prevailed in litigated actions alleging that various cryptocurrencies were securities, including high-profile wins regarding cryptocurrencies Kin and LBC, and the agency continues to litigate its claim that other well-known cryptocurrencies and crypto-assets are securities.[6]

In a hard-fought case against Ripple at the U.S. District Court for the Southern District of New York, the SEC asserted that Ripple's XRP, a cryptocurrency, is a security.[7]

In defending the case, Ripple pointed to a 2018 speech by then-director of the SEC's Division of Corporation Finance, William Hinman, that a cryptocurrency could morph into a nonsecurity after becoming "sufficiently decentralized." [8] Using the framework set forth in Hinman's speech, Ripple claimed that XRP is akin to bitcoin and ether, and therefore not a security.[9]

More recently, on Feb. 16, the SEC filed a complaint against Terraform Labs claiming that five different crypto-assets sold by the company are securities. Among those assets are Luna, Terraform's cryptocurrency, and Terra USD, or UST, Terraform's "algorithmic stablecoin." [10]

Luna is similar to XRP, highlighting the SEC's pursuit of some cryptocurrencies as securities, while UST shares qualities with EMAX, in that both crypto-assets were backed by other crypto-assets.

EMAX's creators hoped that EMAX would provide stability by serving as a reserve currency backed by crypto-assets within the EMAX ecosystem. UST gave holders an opportunity to burn and mint UST with Luna to create arbitrage opportunities for traders to theoretically keep UST pegged to the U.S. dollar.

In the coming months, court determinations as to which of these crypto-assets constitute securities will have major implications for crypto companies and their promoters.

### SEC Actions Against Celebrity Promoters for Alleged Touting

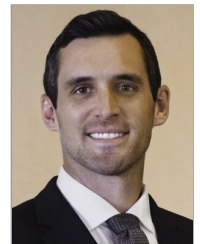
In November 2017, less than four months after The DAO Report, the SEC's Division of Enforcement and the Office of Compliance Inspections and Examinations issued an explicit warning about the applicability of the anti-touting provision, stating that "any celebrity or other individual who promotes a virtual token or coin that is a security must disclose the nature, scope, and amount of compensation received in exchange for the promotion." [11]

Despite this rare, specific warning, the SEC has filed numerous enforcement actions against celebrities for violating the anti-touting provision.

Boxer Floyd Mayweather Jr. and Khaled Khaled, better known as DJ Khaled, both allegedly promoted EMAX, similar to Paul Pierce.[12]



Kurt Gottschall



Payton Roberts

In 2018, the SEC accused Mayweather of touting three ICOs, one of which was also promoted by DJ Khaled. To settle their respective cases, Mayweather agreed to pay \$300,000 in disgorgement and a \$300,000 penalty, while DJ Khaled agreed to pay \$50,000 in disgorgement and a \$100,000 penalty.

In the press release announcing the actions, then-Enforcement Division Co-Director Steven Peikin issued yet another warning regarding celebrity endorsements, saying, "Investors should be skeptical of investment advice posted to social media platforms, and should not make decisions based on celebrity endorsements."<sup>[13]</sup>

Three months later, the SEC brought a similar action against Steven Seagal for touting an ICO for Bitcoin2Gen, or B2G.<sup>[14]</sup>

Seagal promoted B2G on his Twitter and Facebook accounts, allowed his likeness to be utilized on the ICO's official website and participated in associated webinars. He likewise agreed to settle by paying \$157,000 in disgorgement and a \$157,000 penalty.

In October 2020, the commission filed a complaint against well-known software pioneer John McAfee — as well as his bodyguard Jimmy Watson Jr., who allegedly assisted in executing the scheme — for promoting investments for multiple ICOs on McAfee's Twitter.<sup>[15]</sup>

McAfee allegedly received \$1 million in cash and crypto-assets in exchange for his promotions. In July 2022, the SEC's case against McAfee was dismissed following his death, and Watson Jr. settled with the SEC by agreeing to disgorge his profits of \$316,401.

Finally, in October 2022, the SEC charged Kim Kardashian with violating the anti-touting provision based on her promotion of EMAX tokens on social media.<sup>[16]</sup>

Nearly identical to the order against Pierce, the SEC alleged that Kardashian promoted EMAX tokens while failing to disclose her receipt of \$260,000. She agreed to pay \$260,000 in disgorgement and a \$1 million penalty.

### **Celebrities Promoting Crypto Also Face Liability in Private Actions**

Although there is no private right of action under Section 17(b), investors have sued celebrity crypto promoters for a variety of claims under state laws. Among the possibilities, investors have asserted claims under various state securities, unfair competition, deceptive trade practice and consumer fraud laws.

For example, on Jan. 7, 2022, investors in EMAX brought a civil action in the U.S. District Court for the Central District of California against several celebrity promoters and EMAX executives.<sup>[17]</sup>

Pleading many of the same facts later alleged in the SEC's enforcement action, the investors accused the celebrity promoters of encouraging payments with EMAX, touting it on social media, assisting in a fraudulent scheme and allowing the entity to utilize their image and likeness.

In December, however, the case was dismissed with leave to amend. In the dismissal, the court appeared sympathetic to investors by noting that:

This action demonstrates that just about anyone with the technical skills and/or connections can mint a new currency and create their own digital market overnight. Likewise, the action emphasizes the power of social media in allowing celebrities to directly communicate with their millions of fans with a touch of a button. These two facts, together, have seemingly allowed unvetted and highly volatile investment ventures to go viral based solely on the paid-for word of celebrity promoters.<sup>[18]</sup>

Similarly, investors in Voyager crypto-assets have tried recouping losses from promoters — including Mark Cuban, who entered into a partnership on behalf of the Dallas Mavericks with Voyager in 2021 — after the company filed bankruptcy.

Cuban began advocating for cryptocurrency in general in 2020. In announcing a partnership with Voyager, Cuban stated that he hoped that "both parties ... reach a wider, global audience to raise brand awareness and drive cryptocurrency adoption around the world."

Voyager investors likened Cuban's promotion of Voyager to crypto promotions by other celebrities because Cuban purportedly did not disclose the consideration he received. Similar to the EMAX private suit, the investors brought claims under state fraud, securities, unfair trade and deception laws.<sup>[19]</sup>

Finally, in the wake of FTX's collapse, several celebrities, including Tom Brady and Gisele Bundchen, have been accused of violating state securities and unfair trade laws based on their promotion of FTX products.<sup>[20]</sup>

Similar to the SEC's and private actions against other celebrities, investors allege that nearly a dozen celebrity FTX promoters "have never disclosed the nature, scope, and amount of compensation they personally received in exchange for the promotion of the [crypto-asset]," according to a class action filed in the U.S. District Court for the Southern District of Florida in November 2022.<sup>[21]</sup>

### **Takeaways**

Many celebrities are deluged with promotional opportunities in various forms — everything from sophisticated ad campaigns for blue-chip companies to serving as more casual influencers on social media.

It may be tempting for celebrities to accept hundreds of thousands or even millions of dollars in compensation for simply pushing a few buttons to promote crypto-assets to their many followers on social media.

But all would-be crypto promoters — including celebrities — need to think carefully about the regulatory requirements that accompany the federal securities laws.

In many cases, crypto ventures seeking celebrity endorsements appear to have underestimated the extent of the SEC's jurisdiction. While many have advanced creative arguments as to why particular crypto-assets are not securities, most courts have agreed with the SEC's application of the Howey test to many crypto-assets.

Promoters also need to recognize that if the crypto-asset is a security, social media does not lend itself to compliance with the anti-touting provision.

Whereas microcap stock promoters often minimize their disclosure of compensation in footnotes to newsletters or research articles, social media often requires brevity — e.g., Twitter character limits — and a prominent disclosure of compensation on social media may blunt much of the impact of a celebrity endorsement.

Being compensated for promoting a product on social media can seem like free money, but the reality is that crypto promotion also carries significant liability risk to the SEC for touting violations, as well as to investors if crypto-assets lose value.

As the SEC has continued to file anti-touting cases against celebrities touting crypto-assets, it also has ratcheted up the penalties in an apparent attempt to increase their deterrent effect. In 2018, Mayweather and Seagal paid penalties equal to their disgorgement amount, but in the past six months, Kardashian and Pierce paid penalties of approximately four times disgorgement.

The SEC also does not appear swayed by the fact that many of the tokens received by celebrities in exchange for their promotion have plummeted in value.

For example, EMAX tokens once traded for \$5.80, but now the tokens are practically worthless.[22] And in the wake of the collapse of several crypto-assets, investors are often pursuing state law claims against crypto company principals and promoters.

Time will tell if recent setbacks in the crypto industry will temper celebrity endorsements going forward, but given the SEC's increasingly broad view of which crypto-assets constitute securities and the agency's recent court victories on this issue, promoters — including celebrities — need to pay close attention to their disclosure obligations under Section 17(b).


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*Kurt Gottschall is a partner at Haynes and Boone LLP and a former director of the SEC's Denver regional office.*


*Payton Roberts is an associate at the firm.*

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[1] SEC Charges NBA Hall of Famer Paul Pierce for Unlawfully Touting and Making Misleading Statements about Crypto Security, SEC Press Release (Feb. 17, 2023), <https://www.sec.gov/news/press-release/2023-34>.

[2] *In re: Paul Anthony Pierce* , Release No. 11157 (Feb. 17, 2023), <https://www.sec.gov/litigation/admin/2023/33-11157.pdf>

[3] 15 U.S.C. § 77q(b).

[4] *SEC v. Curshen* , 372 F. App'x 872, 878–79, 882 (10th Cir. 2010) (promoter was compensated by receiving stocks and warrants in exchange for promoting the stock).

[5] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Release 81207 (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf>.

[6] See, e.g., *SEC v. Kik Interactive Inc.* , 492 F. Supp. 3d 169, 177–80 (S.D.N.Y. 2020) (finding Kin token as a security); *SEC v. LBRY* , No. 21-CV-260-PB, 2022 WL 16744741 (D.N.H. Nov. 7, 2022) (finding LBC, a cryptocurrency, as a security).

[7] Compl., *SEC v. Ripple Labs*, No. 20-cv-10832 (Dec. 22, 2020), <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-338.pdf>.

[8] William Hinman, Digital Asset Transactions: When Howey Met Gary (Plastic), SEC Speech (June 15, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418>.

[9] Mem. of Law in Supp. of Def. Bradley Garlinghouse's Mot. to Dismiss the Am. Compl. 7, *SEC v. Ripple*, No. 1:20-cv-10832 (SDNY Apr. 12, 2021), ECF No. 111 (citing Solomon Decl., Ex. J, Director William Hinman, Division of Corporation Finance, Remarks at the Yahoo Finance All Markets Summit: Crypto, Digital Asset Transactions: When Howey Met Gary (Plastic) at 3 (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman061418>).

[10] SEC Charges Terraform and CEO Do Kwon with Defrauding Investors in Crypto Schemes, SEC Press Release (Feb. 16, 2023), <https://www.sec.gov/news/press-release/2023-32>.

[11] SEC Statement Urging Caution Around Celebrity Backed ICOs, SEC Statement (Nov. 1, 2017), <https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos>.

[12] Two Celebrities Charged With Unlawfully Touting Coin Offerings, SEC Press Release (Nov. 29, 2018), <https://www.sec.gov/news/press-release/2018-268>.

[13] *Id.*

[14] Actor Steven Seagal Charged With Unlawfully Touting Digital Asset Offering, SEC Press Release (Feb. 27, 2020), <https://www.sec.gov/news/press-release/2020-42>. In a parallel action against B2G, the SEC has accused its founders of defrauding 460 investors with about \$11,400,000 in lost investments. SEC Charges Three Individuals in Digital Asset Frauds, SEC Press Release (Feb. 1, 2021), <https://www.sec.gov/news/press-release/2021-22>. The SEC alleges that B2G was a sham, the founders hid their identities, the entity utilized overseas affiliates to hid transaction, and the defendants misappropriated millions of dollars of investor funds for their own personal benefit. The Department of Justice initiated criminal proceedings against one founder in the Eastern District of New York.

[15] SEC Obtains Final Judgment Against Individual in ICO Promotion Scheme; Files Notice of Death as to John McAfee, Resulting in Dismissal of Claims, SEC Litigation Release No. 25445 (July 15, 2022), <https://www.sec.gov/litigation/litreleases/2022/lr25445.htm>

[16] SEC Charges Kim Kardashian for Unlawfully Touting Crypto Security, SEC Press Release (Oct. 3, 2022), <https://www.sec.gov/news/press-release/2022-183>.

[17] Class Action Compl., In re: EthereumMax Investor Litigation, No. 2:22CV00163 (Jan. 7, 2022), ECF. 1; Second Am. Class Action Compl. (Dec. 22, 2022), ECF. 102.

[18] Order Re: Defs.' Omnibus Mot. to Dismiss and the Individual Defs.' Mot. to Dismiss at 1, No. 2:22CV00163 (Dec. 6, 2022), ECF. 99.

[19] Voyager investors' lawsuit against Cuban remains pending.

[20] Am. Class Action Compl. and Demand For Jury Trial, Garrison v. Bankman-Fried et al., No. 1:22-cv-23753 (Dec. 16, 2022), ECF. 16.

[21] Id. at 8. FTX investors' lawsuit against the celebrities remains pending.

[22] EthereumMax, Coinbase,  
<https://www.coinbase.com/price/ethereummax#:~:text=The%20EMAX%20token%20aims%20to,to%20disrupt%20the%20status%20quo>  
(last visited on Feb. 23, 2023).