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# Judge Mulls Whether Initial Coin Offerings Are Securities

By [Dunstan Priol](#)

Law360 (May 8, 2018, 8:19 PM EDT) -- A Brooklyn federal judge on Tuesday heard two starkly different takes on whether digital tokens issued in an allegedly fraudulent initial coin offering were securities subject to regulation by the [U.S. Securities and Exchange Commission](#), the first time the contentious argument has been put before a federal court.

Maksim Zaslavskiy, who was [indicted by the U.S. Department of Justice](#) for allegedly making fraudulent statements to lure in ICO investors and faces a parallel SEC civil suit, is seeking to have the case dismissed on the grounds the indictment was based on the government's erroneous contention that his coins are securities. A prosecutor argued the coins fit the legal definition of securities because investors expected to earn a profit based on Zaslavskiy's efforts to grow the company.

U.S. District Judge Raymond J. Dearie didn't rule on the motion to dismiss, while expressing uncertainty as to how the new technology should be defined given the very different arguments presented in court.

"This isn't two ships passing in the night. It's two entirely different seas," the judge said. "From whose perspective do I look at this?"

A ruling on Tuesday's motion is expected sometime before the trial date, which the judge set for January 2019.

Zaslavskiy is accused of using his companies REcoin Group Foundation and DRC World Inc., also known as Diamond Reserve Club, to dupe investors into buying nonexistent digital tokens in his REcoin and Diamond initial coin offerings, which he is alleged to have falsely claimed were backed by real estate and diamonds.

Defense attorney Len H. Kamdang of the Federal Defenders of New York Inc. argued in court Tuesday that the securities fraud charges against Zaslavskiy are defective, since Zaslavskiy's digital coins are currencies rather than securities and thus aren't subject to the securities law upon which the charges are based.

Kamdang said Zaslavskiy hoped to create a digital currency for real estate transactions that would evolve in the same manner as older cryptocurrencies such as bitcoin, which, he noted, is accepted as payment by at least one large U.S. sandwich chain.

"That was the vision provided to investors and that's the vision investors bought into," Kamdang said. "There's no question what was marketed here was a new medium of exchange."

The government [has argued in court documents](#) that the REcoin and Diamond tokens pass the [U.S. Supreme Court](#)'s so-called Howey test for determining if a financial instrument is an investment contract and therefore a "security," since both of the purported tokens were "an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."

Prosecutor Julia Nestor told Judge Dearie that Zaslavskiy's coin offering met the legal requirements of an "investment contract" because his investors "depended on the promoter." Zaslavskiy was supposed to build the company out, she added, "but he didn't."

"This is nothing like a regular currency," Nestor said. "These were investors who thought their money was going to grow in value."

Nestor urged the judge not to let the fraud case be distracted by the technology issues raised by Zaslavskiy's defense attorneys. "It's a grand misrepresentation of an idea," she said, reiterating the government's allegations that Zaslavskiy's company had no professional staff, as well as no real estate assets or diamonds, as had been marketed to investors. "There was actually nothing here," she added.

During Tuesday's hearing, Judge Dearie read from Zaslavskiy's marketing materials, which promised investors profits based on the digital coins being backed by real estate assets that would presumably grow in value. "That sure sounds like an investment contract," the judge said.

Kamdang disagreed, arguing that the purpose of the coins was "transactive."

The SEC has argued in Zaslavskiy's case that anti-fraud and other provisions of federal securities laws are "principles-based, broad and flexible," which gives the SEC important tools that can be applied to the use of "novel technologies" in securities activities.

"As the Supreme Court has recognized, Congress crafted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment," an SEC's brief stated.

In what was the agency's first fraud case involving ICOs, the SEC brought its own civil case against Zaslavskiy about a month before the criminal charges hit

Defense attorney Jason Nagi of [Polsinelli PC](#) noted that six different regulators currently police digital

offerings in the U.S., creating what he described as a “lack of clarity” that has allowed issuers like Zaslavskiy to “fall into holes that were dug and left uncovered.”

Zaslavskiy is represented in the DOJ case by Mildred Whalen and Len H. Kamdang of the Federal Defenders of New York Inc. He’s represented in the SEC case by Jason Nagi of Polsinelli PC.

The government is represented by Julia Nestor and Andrey Spektor of the [U.S. Attorney’s Office](#) for the Eastern District of New York.

The case is U.S. v. Zaslavskiy, case number [1:17-cr-00647](#), in the U.S. District Court for the Eastern District of New York.

--Additional reporting by Stewart Bishop. Editing by Alanna Weissman.

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November 21, 2017

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