

Decision by Default: Crypto Precedence or Irrelevance?

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Earlier this year, the United States District Court for the Western District of Washington rendered a default judgment in a matter concerning insider trading at Coinbase, one of the world's largest cryptoasset exchanges.¹ The default judgment dealt with the securities designation of cryptoassets, which has concerned stakeholders in the space.

The Charges

On July 21, 2022, the United States Securities and Exchange Commission (SEC) filed civil and criminal charges against Ishan Wahi, Nikhil Wahi, and Sameer Ramani for alleged insider trading.

On May 30, 2023, the SEC issued a press release announcing that Ishan Wahi and Nikhil Wahi had agreed to a settlement with the SEC for the civil charges and pled guilty under the criminal charges of conspiracy to commit wire fraud.² As a result of their settlement, the Wahi brothers each agreed to be permanently enjoined from violating Section 10(b) of the *Securities Exchange Act* of 1934 and Rule 10b-5, in addition to paying disgorgement of ill-gotten gains including prejudgment interest. The SEC claimed the civil payment was satisfied as a result of the Wahi brothers' criminal charge payment, and similarly decided to not seek civil penalties due to the Wahi brothers' impending prison sentences.

Ramani was not named in the press release because he remains at large. Since being served on May 26, 2023, Ramani has not submitted any pleadings or defenses to the SEC's complaint or amended complaint. In the SEC's initial filing, they noted their belief that Ramani was in India, but that they were uncertain where Ramani is currently staying. As a result of Ramani's disappearance, on October 19, 2023, the SEC requested that the Court Clerk enter a default judgment against him.

The Decision

On March 1, 2024, a federal judge in the Western District Court of Washington issued a ruling against Ramani, noting that he appeared to have fled the country to avoid criminal prosecution.³ This ruling agreed in part with the SEC's request for a default judgment and could have broader implications regarding the trading of certain cryptoassets on secondary markets, which in this case was deemed to be a securities transaction.

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Judge Tana Lin found that this case was under SEC jurisdiction as the cryptoassets in question were securities, after an analysis of the facts of the case under the *Howey* test. The *Howey* test is precedential jurisprudence that determines whether an instrument or series of transactions constitute an investment contract, and thereby become a security for the purposes of regulation. The Canadian equivalent of the *Howey* test is the *Pacific Coin* test, which follows the same general analysis.⁴

Under the *Howey* test, an instrument needs to satisfy the following in order to be considered an investment contract: “(1) an investment of money (2) in a common enterprise (3) with an expectation of profits produced by the efforts of others.”⁵

(1) Investment of Money

This prong is generally held to be a low bar and is satisfied by lower evidentiary thresholds. In this matter, Ramani paid for the tokens that he purchased himself, thus satisfying the first prong of the *Howey* test.

(2) Common Enterprise

In US jurisprudence, the common enterprise prong can be satisfied by “horizontal commonality” and/or “vertical commonality.”

Horizontal commonality is established when an issuer uses investor proceeds to develop a business, which becomes tied to all investors and thus ties the financial fortunes of all investors together. Ramani and the Wahi brothers informed investors that they intended to use the pooled proceeds from investors to launch and develop a business that would collectively benefit all parties in relation to the tokens. As such, horizontal commonality was found to exist.

Vertical commonality is established when it can be demonstrated that the fortunes of the investors are linked with those of the promoters. Ramani and the Wahi brothers retained a substantial number of tokens for their management teams, for the specific purpose of aligning the financial fortunes of management and token-holders, creating a shared risk of loss. As such, vertical commonality was also found to exist.

With both forms of commonality established, the court determined that this prong of the *Howey* test was also satisfied.

(3) Reasonable Expectation of Profits Induced by Efforts of Others

Finally, the third prong can be broken into two separate analyses: (a) a reasonable expectation of profits, (b) induced by the efforts of others. Regarding the former, this requirement may generally be satisfied if it can be demonstrated that there were particular “economic inducements” provided to prospective investors to entice them into investing. In the Coinbase matter, the issuers of Ramani’s trades broadly and repeatedly

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disseminated claims that each token would appreciate in value. Moreover, the issuers promoted the tokens based on the promoter's management team's ability to create, develop, and maintain an ecosystem that would increase the demand and price for a token. The court found that "any objective investor would [...] have expected to profit from trading in the tokens."

Regarding the latter, Ramani's interests were aligned with investor interests – going as far as to claim that "[t]he more money you make, the more money we make." With this, the court found that an objective investor would have determined that the reasonable expectation of profit would be derived, at least in part, by the efforts of others, which here would be Ramani.

Given the totality of the assessment, the court ruled that Ramani's promotion of the tokens constituted an investment contract. However, this analysis was particular to the purchase of directly issued tokens.

The court extended the same analysis to Ramani's trading of tokens on the secondary market. The court held that the "economic reality of each transaction" must be considered, and that the promotional statements and managerial promises of the issued tokens apply equally whether the investor purchased the tokens from the issuer or from another investor. This analysis was coupled with the fact that each issuer continued to make representations on the value of the token even as they were being traded on secondary markets.

Thus, per the *Howey* test, all of the cryptoassets that were purchased and traded by Ramani were investment contracts and fall under the purview of securities regulation.

Implications for Cryptoasset Regulation

This decision has led to concern among stakeholders in the cryptoasset space regarding the implications it may have on future regulation of the industry. Coinbase's Chief Legal Officer, Paul Grewal, said in a public release on X (formerly Twitter), that the fact that the decision was rendered through a default judgment proceeding makes it "not worth anything as precedent or persuasion." Similarly, Stuart Alderoty, Ripple's Chief Legal Officer, echoed similar views, saying "[relying] on a default judgement is like me challenging Conor McGregor to a fight and when he doesn't show up I shadow box for a few rounds and then declare myself the champion". Although said tongue-in-cheek, it remains unclear how the default judgment will be treated moving forward. The point is taken that there was no defendant to contest the SEC's claims, but the judge in the Coinbase matter still had to consider the strength and validity of the SEC's arguments prior to rendering their decision.

For the purposes of this article, we will briefly examine the US jurisprudence on the precedential value of decisions made in default judgments and will provide an analysis of the precedential value of default judgments in Canada, to determine whether this decision may find a persuasive foothold in Canadian

courts.

US Jurisdiction

The default judgment could have implications for future cases, but how much influence it could have is unclear. Although a default judgment likely has less precedential value than a judgment following trial (or other types of hearings in which the parties present their cases in an adversarial manner), the fact remains that the default judgment is a decision by a federal judge. The SEC has already submitted the default judgment as supplemental authority in other cases, which the opposing lawyers have taken issue with.

Canadian Jurisdiction

In Ontario, default judgments are governed by the *Rules of Civil Procedure*, which fall under the *Courts of Justice Act*. In particular, Rule 19 outlines how a plaintiff may conclude a proceeding in which the defendant has failed to respond in the prescribed manner.⁶ The approach to initiating a default proceeding is similar across Canadian provinces.

Even when plaintiffs have successfully obtained default judgment, the defendant is allowed to “set aside” a default judgment. A defendant who has been noted in default is deemed to have admitted all allegations listed in the statement of claim and, once default judgment is granted, the defendant cannot take any steps other than to bring a motion to ask the court to set aside the default judgment.⁷

In 2014, the Ontario Court of Appeal in *Mountain View Farms Ltd. v McQueen*⁸ ruled that the test for setting aside a default judgment is centered around the question of whether the interests of justice favour granting the order. In coming to this decision, the Court of Appeal determined that five factors must be considered:

- Whether the motion for setting aside the default judgment was brought promptly after being made aware;
- Whether there is a plausible excuse or explanation for the defendant’s default;
- Whether the defendant has an arguable defense on the merits;
- The potential prejudice to the moving party weighed against the potential prejudice to the respondent regarding the motion; and
- The effect the order of the court might have on the overall integrity of the administration of justice.

This approach has been repeatedly confirmed in subsequent cases.

While many default judgments in Canada are issued without detailed (or any) reasons, where the matter does result in detailed reasons for the decision it is likely that a such a decision would be of, at least some, precedential value. The argument may remain that the default judgment should be considered with a caveat because the judge was only able to consider the plaintiff’s submissions, but nonetheless, the submissions

made by the plaintiff were compelling enough to warrant the judge's decision.

Takeaways

On the tails of the *SEC v Ripple Labs*⁹ and *SEC v Terraform Labs*,¹⁰ which provided conflicting judgments on whether cryptoassets should be considered securities,¹¹ this new decision on Coinbase clouds the future of cryptoasset regulation. As discussed above, it is unclear what the precedential value of the Coinbase decision will be; however, this "win" for the SEC will likely be influential in shaping future discussion of the designation of cryptoassets.

For more information on how this decision may affect you or your organization, we welcome you to contact our Blockchain & Digital Assets Group to assist you further.

¹ *Securities and Exchange Commission v Wahi*, 2:22-cv-01009, (WD Wash Mar 01, 2024) ECF No. 119.

² US Securities and Exchange Commission, "Former Coinbase Manager and His Brother Agree to Settle Insider Trading Charges Relating to Crypto Asset Securities" (30 May 2023).

³ *Securities and Exchange Commission v Wahi*, *supra* note 1.

⁴ *Pacific Coast Coin Exchange v Ontario Securities Commission*, [1978] 2 SCR 112 (*Pacific Coin*).

⁵ *SEC v Howey Co.*, 328 U.S. 293 (1946) (*Howey*).

⁶ *Courts of Justice Act*, RRO 1990, Reg 194: Rules of Civil Procedure, s 19 [*RCP*].

⁷ *Ibid* at 19.02(1) and 19.08.

⁸ *Mountain View Farms Ltd. v McQueen*, 2014 ONCA 194.

⁹ *SEC v Ripple Labs, Inc, Bradley Garlinghouse and Christian A. Larsen*, 20 Civ. 10832 (AT).

¹⁰ *SEC v. Terraform Labs Pte. Ltd.*, 2023 WL 8944860.

¹¹ Both *Ripple* and *Terraform* were both 2023 decisions from the Southern District of New York.