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No Harm, But Still a Foul: Ontario Securities Commission Takes Strong Stance on Misleading Disclosure in the Emerging Crypto Industry

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The Ontario Securities Commission (OSC) announced a settlement agreement with NextBlock Global Limited (NextBlock) and co-founder, director and Chief Executive Officer Alex Tapscott (Tapscott), in connection with misleading statements made in offering memoranda.

Key Takeaways

- The OSC is sending a decisive message to those operating in the emerging cryptocurrency industry that it expects full compliance with applicable legislation where an issuance of cryptocurrency constitutes a distribution of securities.
- Informal slide decks that are commonly circulated to prospective investors in the cryptocurrency industry may be subject to the requirements of subsection 122(1)(b) of the *Securities Act*, RSO 1990, c S.5 as amended (the Act).
- The Settlement demonstrates the OSC's continued emphasis on fair and accurate information in disclosure materials, including engaging in enforcement efforts even where investors suffer no financial losses.

Summary and Background

On May 13, 2019, the OSC ordered the approval of a Settlement Agreement with NextBlock and Tapscott. The settlement followed Tapscott's and NextBlock's admissions that they made misleading or untrue statements in offering memoranda provided to over 100 prospective investors in a private placement that raised approximately $20 million from 113 accredited investors. These offering memoranda took the form of investor slide decks and represented certain prominent figures in the blockchain space as NextBlock's advisors when these individuals had not agreed to act as its advisors and had not consented to being included in the investor slide decks.

Shortly after it was discovered that the offering memoranda contained misleading statements, NextBlock brought a plan of arrangement before the Ontario Superior Court of Justice with a view to winding up NextBlock and making distributions to investors. Due to a significant increase in the value of its investments, NextBlock generated significant profits and returned to its investors their initial investments of approximately $20 million, as well as additional distributions of approximately $28 million, representing approximately a

140% profit on their investment.

Nonetheless, in connection with the OSC's finding that the conduct at issue constituted a breach of subsection 122(1)(b) of the Act, NextBlock agreed to pay an administrative penalty of $700,000 and costs of $100,000, while Mr. Tapscott agreed to pay a penalty of $300,000 and pen an open letter in which he addresses the impact and consequences of his misconduct. As a show of good faith, Tapscott also volunteered to deliver presentations on business ethics to students at Canadian business schools, declined approximately $3 million in carried interest that he was entitled to based on NextBlock's profits and elected not to receive a salary during the relevant period. The respondents also settled with the Securities and Exchange Commission (SEC), agreeing to pay a US$25,000 civil penalty.

Notably, the settlement does not include a future prohibition against Tapscott acting as an officer or director. While the OSC noted that such a ban might be called for on these facts, Tapscott's clear and public acknowledgment of responsibility, lack of prior disciplinary record with a securities regulatory authority and decision to forego funds earned in connection with his conduct served as mitigating factors. Putting the cryptocurrency industry on notice, the OSC commented that an individual in a future similar case might encounter more difficulty avoiding such a ban.

The Trends

The OSC took this opportunity to reiterate the importance of fair and accurate information in disclosure materials provided to prospective investors. Mr. Jeff Kehoe, Director of the OSC Enforcement Branch summarised: "this settlement reinforces an important message: We will take action to address misleading disclosures and the serious harm it causes to Ontario investors and our markets, even if investors suffer no financial losses."

As the OSC continues to grapple with regulating the emerging cryptocurrency market, a clear message has been sent to the industry that consequences will flow from any and all breaches of applicable securities regulations, regardless of whether tangible damages or losses to investors result. It is evident, however, that the conduct of the respondents during and after the misconduct can play a significant mitigating role in the resulting penalties.

The joint investigative and enforcement effort undertaken by the OSC and SEC is indicative of an increasing trend of cross-border collaboration amongst regulatory bodies in regulating the cryptocurrency market. Given the inter-jurisdictional nature of many blockchain transactions as well as the ability to market and distribute cryptocurrencies internationally, developing a framework for the unified regulation of cryptocurrency is of paramount importance to the long-term viability of the industry.

A link to the Oral Ruling and Reasons of the OSC can be found here, a link to the Settlement Agreement can be found here, and a link to the OSC Order can be found here.

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For further information regarding the developing regulatory framework in the cryptocurrency industry, please contact Wendy Berman, Brigeeta Richdale, David Kelman, or any other member of our Securities Litigation Group.

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