

Clash of the Titans: SEC Sues Genesis and Gemini for Digital Asset Offerings

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Like Zeus unleashing the Kraken in *Clash of the Titans*,¹ the U.S. Securities and Exchange Commission (SEC) has unleashed the Kraken (not the digital asset company) to unleash havoc on Genesis Global Capital LLC (Genesis) and Gemini Trust Company LLC (Gemini). The monster unleashed by the SEC is the U.S. Supreme Court's decision in *Reves v. Ernst & Young*.² In *Reves*, the Court established a test for when a note is a security. Under Section 2(a)(1) of the Securities Act, the definition of a security includes any "note."³ A note is presumed to be a security unless it bears a strong resemblance to instruments that are not securities, which courts determine by examining four factors:

1. The motivation of the parties;
2. The plan of distribution;
3. The expectations of the investing public; and
4. The availability of an alternative regulatory regime that "significantly reduces the risk of the instrument" for investors other than the securities laws, "thereby rendering application of the Securities Acts unnecessary."⁴

The action against Genesis and Gemini is the most recent action in which the SEC applies *Reves* to the digital asset space.

Gemini Earn Program

Under the terms of the Gemini Earn Agreement, Gemini Earn investors first had to hold eligible digital

assets with Gemini — either by transferring the digital assets to Gemini or acquiring them via Gemini’s crypto asset trading platform. Through Gemini Earn, investors would then tender their digital assets to Genesis, with Gemini acting as the agent for retail investors to facilitate the transaction. Gemini aggregated the digital assets to be invested in the Gemini Earn program and placed them in a digital wallet from which Genesis would then take possession of the assets. While Genesis was the issuer and entity that received, pooled, deployed, and paid interest on investors’ assets, Gemini provided retail investors with access to Genesis, and acted as the agent in the issuance. Upon receiving the interest payments from Genesis, Gemini would deduct an “Agent Fee” before distributing the remainder of the interest payments to Gemini Earn investors.

The SEC complaint states that for three months, ending on March 31, 2022, Genesis received approximately \$169.8 million in interest income from institutional borrowers and paid \$166.2 million in interest to the investors in its digital asset program, including Gemini Earn. Genesis also loaned an additional \$575 million worth of digital assets, including those of Gemini Earn investors, to Genesis’s parent company, Digital Currency Group (DCG), which DCG used to fund investment opportunities and repurchase DCG stock from non-employee shareholders in secondary transactions. As of October 2022, the net interest rate offered to Gemini Earn investors ranged from 0.45% to 8.05%, while Gemini’s Agent Fee ranged from 0.06% to 4.29%, depending on the type of digital asset tendered to Genesis. In November 2022, Genesis announced that it would not allow hundreds of thousands of retail investors to withdraw their digital assets from Gemini Earn because “withdrawal requests [] exceeded [its] current liquidity” following volatility in the digital asset market. At the time, Genesis held approximately \$900 million in investor assets from approximately 340,000 Gemini Earn investors, most residing in the United States. As of Jan. 12, 2023, the date the complaint was filed, these retail investors still could not withdraw their assets.

Genesis and Gemini Meet *Reves*

The SEC’s complaint⁵ against Genesis and Gemini alleges that Genesis and Gemini violated Sections 5(a) and 5(c) of the Securities Act of 1933 by offering and selling digital asset securities that were not registered with the SEC or sold pursuant to a safe harbor from registration.⁶ The complaint provides that Gemini touted that its partnership with a digital asset lender enabled participants in the Gemini Earn program to “receive more than 100x the average national interest rate” and receive “among the highest rates on the market.” Gemini further encouraged investors to “Put your crypto to work. With Gemini Earn, you can receive up to 8.05% APY on your cryptocurrency.”

The SEC alleges the instruments offered by the parties were debt securities under the *Reves* test and constituted the offer and sale of investment contracts under the *Howey* test.⁷ The SEC considered that Genesis intended to use the digital assets for its business and its sole source of revenue and that the Gemini Earn investors were primarily motivated to earn a profit on their digital assets in the form of interest.

The SEC’s action against Genesis and Gemini is the most recent in a series of enforcement actions involving digital assets the SEC alleges are securities. The SEC is reinforcing its position that interest-bearing accounts leveraging decentralized finance lending protocols could be securities. Indeed, SEC Chairman Gary Gensler noted that the Genesis and Gemini lawsuit “build[s] on previous actions to make clear to the marketplace and the investing public that crypto lending platforms and other intermediaries need to comply with our time-tested securities laws.”⁸

Conclusion

In *Clash of the Titans*, Perseus was able to defeat the Kraken using the head of the Medusa. It is unclear if there is a metaphorical head of a gorgon that can be used to defeat the SEC. Whether the SEC will be able to establish the elements of the Reves test or if they will settle with the SEC is unclear.

The Genesis and Gemini lawsuit is yet another example of the SEC's position that certain activities taken in the digital asset space are not exempt from complying with U.S. securities laws simply because the asset involved is a digital asset. Developers of digital assets and digital asset-related programs must proceed with a high degree of caution. The SEC continues to display a strong willingness to initiate investigations and enforcement actions against issuers of digital assets that are viewed as securities under the *Howey* and *Reves* tests.

¹ *Clash of the Titans* (1981).

² 494 U.S. 56 (1990).

³ See 15 U.S.C. §§ 77b, 78c.

⁴ *Reves*, 494 U.S. at 64–69.

⁵ [Securities and Exchange Commission v. Genesis Global Capital, LLC and Gemini Trust Company, LLC](#), Case No. 1:23-cv-00287 (S.D.N.Y. Jan. 12, 2023).

⁶ We use the term “digital asset” in the same manner as the SEC to refer to “an asset that is issued and transferred using distributed ledger or blockchain technology.” [Statement on Digital Asset Securities Issuance and Trading](#), Division of Corporation Finance, Division of Investment

Management, and Division of Trading and Markets, SEC (Nov. 16, 2018). As the SEC has noted, digital assets include, but are not limited to virtual

currencies, coins, and tokens. *Id.* A digital asset may in certain instances be deemed a security under the federal securities laws. While not defined in

the securities laws, the SEC often refers to digital assets that are securities as a “digital asset securities.” *Id.*

⁷ An investment contract is (i) an investment of money, (ii) in a common enterprise, (iii) with a reasonable expectation of profits, (iv) derived from the entrepreneurial or managerial efforts of others. *Securities and Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

⁸ SEC Press Release, [“SEC Charges Genesis and Gemini for the Unregistered Offer and Sale of Crypto Asset Securities through the Gemini Earn Lending Program”](#) (Jan. 12, 2023).

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