

Celebrity Endorsers of Initial Coin Offerings Settle with Securities and Exchange Commission

The Bottom Line

- Celebrities not only need to comply with the FTC Endorsement Guides but also need to comply with the SEC's disclosure rules when endorsing ICOs, or risk facing charges similar to those brought against Khaled and Mayweather.
- These recent charges reflect the SEC's concern around the increased popularity of cryptocurrency, the prevalence of fraud, and the importance of endorsement disclosures in this area.

Music producer and rapper DJ Khaled and boxer Floyd Mayweather Jr. settled allegations brought by the U.S. Securities and Exchange Commission (SEC) that they failed to disclose the payments they received for promoting investments in initial coin offerings (ICOs).

While these were the SEC's first cases to charge endorsement violations involving cryptocurrency, they likely will not be the last, in light of the increasing popularity of cryptocurrency and the rise of celebrities and other influencers looking to leverage potentially lucrative partnerships in this arena.

The Background

An ICO is a fundraising mechanism for cryptocurrency. New coins solicit "investments" in the form of established cryptocurrency, and, in exchange, the new coins gain exposure and generate value. In this sense, an ICO is not too dissimilar from an IPO for stocks. However, not all ICOs – or cryptocurrency offered by ICOs – are governed by the SEC. The SEC regulates "securities," but the SEC has made clear that not all cryptocurrency qualify as securities. In July 2017, however, the SEC issued a report warning that so-called coins sold in ICOs "may be securities" and that an unregistered ICO may, therefore, constitute an illegal public offering.

While there remains significant uncertainty regarding the SEC's regulatory authority over cryptocurrency, cryptocurrency have exploded in popularity over the past few years. In November 2017, the SEC acknowledged the increasing visibility of celebrities promoting investments in the crypto space, and issued a "Statement Urging Caution Around Celebrity Backed ICOs." Acknowledging that celebrities and others "are using social media networks to encourage the public to purchase stocks and other investments," the SEC emphasized that investment decisions must be made with care and that celebrities "do not have sufficient expertise to ensure that [an] investment is appropriate and in compliance with federal securities laws."

In turn, the SEC emphasized the importance of disclosure requirements for celebrities when accepting compensation in exchange for the promotion of a security or security offering. Specifically, in the words of the SEC, a celebrity endorsement of a security "may be unlawful if they do not disclose the nature, source, and amount of any compensation paid, directly or indirectly, by the company in exchange for the endorsement."

The Charges

The SEC found that in September 2017, Khaled failed to disclose a \$50,000 promotional payment from Centra Tech Inc., a Miami-based company that conducted an ICO for its “Centra tokens.” Khaled promoted the ICO on his Instagram and Twitter accounts as a “game changer.”

The SEC also determined that Mayweather failed to disclose \$300,000 in promotional payments from three ICO issuers, including \$100,000 from Centra Tech, which he promoted on his Instagram, Twitter, and Facebook accounts. His endorsements included a message to his Twitter followers that Centra’s ICO “starts in a few hours. Get yours before they sell out, I got mine.” In addition, Mayweather predicted on his Instagram account that he would make a large amount of money on another ICO and posted on Twitter that, “You can call me Floyd Crypto Mayweather from now on.”

The SEC found that the ICOs touted by Khaled and Mayweather qualified as securities, and that both failed to make the necessary disclosures regarding their compensation in exchange for promoting them. Neither Khaled nor Mayweather admitted or denied the SEC’s findings, but both agreed to settle on similar terms.

Khaled agreed to pay \$50,000 in disgorgement, a \$100,000 civil monetary penalty, and \$2,725 in prejudgment interest, and Mayweather agreed to pay \$300,000 in disgorgement, a \$300,000 civil monetary penalty, and \$14,775 in prejudgment interest.

In addition, Khaled agreed not to promote any securities – including digital securities – for two years, and Mayweather agreed not to promote any securities – also including digital securities – for three years.

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