



In *Audet v. Fraser*, an unusual case where federal jurors in a class action lawsuit considered whether digital assets known as "Hashlets" constitute securities, the District of Connecticut jury found that the Hashlets were not securities, and therefore the defendant was not liable for securities fraud. Notably, the SEC took a contrary position on Hashlets in 2015, when it [sued](#) GAW Miners, LLC, its founder Homero Joshua Garza, and another company founded by Garza for securities fraud, alleging that Hashlets were, in fact, securities.



Both companies were permanently [enjoined](#) from violating

securities laws and ordered to disgorge more than \$10 million, and each was ordered to pay a \$1 million civil penalty. Garza was later [sentenced](#) to 21 months imprisonment in a related criminal case. The jury's verdict comes as the SEC has expressed increased interest in regulating digital assets as securities. For example, in November, SEC Chair Gary Gensler [noted](#) that his staff's enforcement mission includes bringing "novel" and "high-impact" cases involving crypto. And in September, Gensler [called for](#) greater regulation of crypto assets, likening the environment in crypto finance, issuance, trading, and lending to "the Wild West." While increased enforcement in crypto markets may be on the horizon, the jury's decision in *Audet* highlights some of the uncertainties that currently pertain to the regulation of digital assets, such as "Hashlets." **Background** In *Audet*, the plaintiff class alleged that Stuart Fraser, a 41% investor in GAW Miners, was liable for securities fraud and aiding and abetting common law fraud. GAW Miners was a company focused on virtual currency mining, which involves using computer processing power to solve complex equations to validate cryptocurrency transactions. The first miner to solve an equation is rewarded with new units of cryptocurrency. According to [court filings](#), GAW Miners initially sold virtual currency mining equipment, but it soon expanded its business to include hosted mining, under which customers purchased equipment stored by GAW Miners and controlled remotely by customers. GAW Miners also began to sell Hashlets, which were contracts under which purchasers would own portions of the miners' computing power and be entitled to a share of the profits GAW Miners earned by mining virtual currencies. The *Audet* plaintiffs alleged that GAW Miners sold far more Hashlets than they had computing power to support, and owed Hashlet purchasers more in returns than they could earn on their mining operations. To pay purchasers promised returns, according to plaintiffs, GAW Miners engaged in a Ponzi scheme, paying earlier purchasers with the money GAW Miners earned from new purchasers. To find Fraser liable for securities fraud, the jury first had to find that Hashlets, or one of the other digital assets at issue in the case, were securities. Under the test announced by the Supreme Court in *SEC v. W.J. Howey Co.*, an asset is a security if there is (1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits to be derived solely from the efforts of others. Fraser's counsel argued that Hashlets failed the *Howey* test's second and third elements. According to the defense, Hashlets were not an investment in a common enterprise—the second element—because there was no horizontal commonality among Hashlet owners and no vertical commonality between Hashlet owners and GAW Miners. Specifically, the fortunes of Hashlet owners were not horizontally tied together because the owners of the same Hashlet could have different results depending on the pool in which they chose to mine. Moreover, the defense argued, GAW Miners and the fortunes of the Hashlet owners were not vertically tied together because GAW Miners charged the Hashlet owners a fixed maintenance fee, which did not alter the Hashlet owners' expectation of profits. As to the third element, Fraser argued that Hashlet purchasers did not have a reasonable expectation of profits to be derived solely from the efforts of others because Hashlets were not a passive investment, and Hashlet owners retained active control over their investment. Ultimately, the jury agreed with the defense and found that Hashlets were not securities. **Looking Forward** At first glance, the *Audet* jury's verdict might give persons offering digital assets reason to hope that their conduct will not fall under the broad umbrella of state and federal securities laws. In the long run, however, it is more likely that this case will prove to be an outlier:

- First, the *Audet* jury instructions may be inconsistent with the test announced in *Howey*. Specifically, as to the third prong of the *Howey* test, the jury instructions stated the following: "If there was a reasonable expectation of significant investor control, then profits would not be considered derived solely from the efforts of others." Yet the test announced in *Howey* found an investment contract exists if there is "an investment of money in a common enterprise with profits to come solely from the efforts of others," and did not include an assessment of investor control. While this additional assessment of investor control is not necessarily inconsistent with the *Howey* test, it is unclear how it was interpreted by the jury or what facts influenced their conclusion on this point.
- Second, the jury may have been influenced by the fact that Fraser—the only defendant remaining in the case at the time of trial—was a minority investor who argued that he had no authority over GAW Miners' operations and that he himself was a victim of GAW Miners' alleged Ponzi scheme.
- Third, although the judge in the *Audet* case left to the jury the question of whether the digital assets were securities, most courts treat the question of whether a transaction constitutes a security as a question of law (e.g., *United States v. Carman*) or at least as a mixed question of law and fact (e.g., *In re Nat'l Mortg. Equity Corp. Mortg. Pool Certificates Sec. Litig.*). It is unusual for a jury to be given the question, and it is unlikely that many future juries will have total control over determining whether a particular crypto offering is a security, like the *Audet* jury did.

The SEC's enforcement priorities are unlikely to be deterred by a single jury's fact-specific and idiosyncratic verdict. If anything, the *Audet* jury's verdict may garner a reaction from regulators that swings in the opposite direction. Yet this case raises important questions about whether the courts or Congress might provide greater clarity about the interpretation of the *Howey* factors—especially as cases involving digital assets are litigated in other state and federal courts.

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