

## Mitigating Crypto UDAAP Risk After Ripple ICO Ruling

By **Ali Abugheida** (March 12, 2020)

Cryptocurrency advocates have long argued that cryptocurrencies are not securities, and therefore not subject to state and federal securities laws.

But a district court in California just shed light on whether advocates' desired outcome also carries a substantial downside: application of state and federal laws against unfair, deceptive, or abusive acts or practices, such as California's Unfair Competition Law.



Ali Abugheida

### **State and Federal UDAAP Laws Typically Do Not Apply to Securities Transactions**

California's UCL, like other UDAAP laws, prohibits unlawful, unfair or fraudulent business acts or practices. While that sounds simple enough, application of that rule is far from straightforward because, among other issues, courts have not settled on a precise definition of the meaning of "unfair" in this context, and, as a result, courts have held or permitted any number of claims to proceed on the theory that the conduct alleged is unfair.

These types of lawsuits have addressed everything from de minimis fees charged by financial institutions to complaints about the fine print on food packaging — essentially anything that someone could conceivably conceptualize as unfair.

Because UCL and UDAAP claims are almost always asserted on a putative class action basis, even a single consumer complaint can create significant risk for a company.

In a putative class action, one or more individuals assert claims on behalf of all of the company's customers. And they will usually seek damages on behalf of all customers as well as injunctive relief.

Thus, even where small-dollar fees, charges or products are at-issue, the exposure can be significant. When injunctive relief is factored in, UCL and UDAAP class actions have the potential to be devastating to a company.

Unlike most business transactions, securities transactions have largely avoided UCL scrutiny since 2004, when a California appellate court ruled in *Bowen v. Ziasun Technologies Inc.* that the UCL does not apply to securities transactions. And, for the most part, this rule has been followed ever since.

The main rationale in *Bowen* is simple: The UCL does not apply to securities transactions because it is based on the Federal Trade Commission Act, and the FTC has not historically applied that act to securities transactions.

The vast majority of states that have addressed this issue have similarly held that their state's UDAAP laws do not apply to securities transactions, either.

But if cryptocurrencies are not securities, it stands to reason that they would be subject to state UDAAP laws like the UCL.

## **California Federal District Court Holds That California’s UDAAP Laws May Apply to Cryptocurrency Transactions**

On Feb. 26, in a consolidated class action matter called *In re: Ripple Labs Inc. Litigation*, the U.S. District Court for the Northern District of California was the first to consider whether cryptocurrency transactions are subject to UDAAP laws.[1]

In its motion to dismiss, Ripple argued that the plaintiffs’ UDAAP claims should be dismissed pursuant to *Bowen* because the plaintiffs asserted that XRP, Ripple’s cryptocurrency, is a security under state and federal law.

The court recognized the holding in *Bowen*, but declined to extend its applications to all cryptocurrencies holding that cryptocurrency transactions may be subject to UDAAP laws in the event that the cryptocurrency is determined not to be a security.

The court’s ruling in the Ripple matter is a significant one. If, as many maintain, cryptocurrencies are not securities, then they will likely be subject to UDAAP laws. And, as discussed above, putative class actions based on alleged UCL violations are among the most common and expensive types of lawsuits.

With the Ripple Labs ruling, there may be a significant uptick in putative class actions targeting the cryptocurrency industry, especially those based in California, which may be burdensome and costly to defend.

### **What to Do if UDAAP Laws Apply to Cryptocurrency Transactions: Three Tips for Mitigating UDAAP Risk**

While it is difficult to anticipate and prevent the filing of lawsuits or government enforcement actions based on alleged UDAAP violations, there are a few ways to mitigate against a potential UDAAP class action.

#### ***1. Review and Update Account Agreements/Terms of Service***

Because UDAAP claims are often based on language in a consumer agreement — such as an account agreement or a company’s terms of service — cryptocurrency providers should review any consumer agreements they may have to ensure that (1) any account charges are clearly and adequately identified and described in the agreement, and (2) the agreement accurately describes the provider’s current business practices.

Addressing these issues will mitigate against a consumer’s claim that he or she was deceived by an inaccurate agreement.

#### ***2. Review Marketing Materials and Practices***

Likewise, providers should review their marketing materials and practices to ensure that any claims made in advertisements or elsewhere, including social media, are clear, accurate and sufficiently supported.

Providers should pay special attention to any marketing materials that consumers may inevitably see as part of their experience with the company. For example, if consumers must sign up or purchase services through the provider’s website, the provider should review its website to ensure that any claims it makes are accurate and that appropriate disclosures are provided.

### **3. Implement and Update Arbitration Agreements**

Finally, one of the best defenses to a UCL class action can be an arbitration agreement with an appropriate class action waiver.

Cryptocurrency providers may wish to review their agreements now to ensure that (1) their agreements include arbitration provisions and (2) their arbitration agreements and class action waivers are up to date.

This is especially true in light of the California Supreme Court's relatively recent decision in *McGill v. Citibank NA*, which held that the agreements that waive a plaintiff's right to seek public injunctive relief in any forum are unenforceable because they are against California public policy.

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*Ali M. Abugheida is counsel at Buckley LLP.*

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[1] In re: Ripple Labs Inc. Litigation, No. 4:18-cv-06753-PJH, ECF No. 85 (N.D. Cal. Feb. 26, 2020).