

Lessons From Steven Seagal On Digital Asset Endorsements

By Michael Buffardi (April 30, 2020)

Actor, producer, reserve deputy sheriff, U.S.-Russia special envoy, writer, blues musician, reality television star, martial arts instructor and 7th dan black belt in aikido, Steven Seagal, recently found himself "Under Siege"[1] from the U.S. Securities and Exchange Commission.



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On Feb. 27, the SEC accepted an offer by Seagal to settle allegations that he violated U.S. securities regulations.[2] The action against Seagal is a reminder that, when it comes to securities compliance, nobody is "Above the Law"[3] and a lack of compliance may send the SEC "Out for Justice." [4]

In its enforcement action, the SEC alleged Seagal promoted an initial coin offering called Bitcoin2Gen, or B2G, which the SEC determined were investment contracts per Section 2(a)(1) of the Securities Act.[5] From Feb. 12, 2018 through March 26, 2018, Seagal promoted the securities offering on platforms such as his Facebook and Twitter accounts, his likeness was used in marketing materials for B2G and on the ICO issuer's website, and he participated in a webinar with potential investors.

For this endorsement, B2G was to pay Seagal \$250,000 in cash and \$750,000 in B2G tokens.

The SEC further alleged Seagal failed to disclose he was a paid promoter of B2G, a violation of Section 17(b) of the Securities Act. Section 17(b) prohibits the use of interstate commerce, instruments of transportation or communication to publish or provide publicity for an offer of a sale of a security, for compensation, without fully disclosing the receipt of and amount of the compensation.[6]

To settle the allegations, Seagal agreed to pay a disgorgement of \$157,000, prejudgment interest of \$16,448.76, as well as a civil money penalty of \$157,000. Seagal is also prohibited from receiving direct or indirect compensation for promoting a security for three years.[7]

During that period of time, promoting B2G, or any other digital asset that qualifies as a security, will be "Out of Reach"[8] for the action star.

Determining Whether a Digital Asset is a Security

While many people associate securities with shares of publicly traded companies, a financial arrangement does not need its own ticker[9] symbol to be considered a security. By definition, a security can include stocks, bonds, transferable shares and investment contracts.[10]

At first glance, digital assets may seem complicated to define, given the technology surrounding their creation and utilization. However, no contractual agreement or financial instrument is "Beyond the Law"[11] of the precedential analysis for determining whether it qualifies as a security.

Given the novel nature of digital assets, the primary determination of whether an ICO qualifies as a security is if it meets the definition of investment contract. In SEC v. W.J. Howey Co., the U.S. Supreme Court established a test to identify the existence of an investment contract, a test that has been continuously relied on as precedent since the case was decided in 1946.[12]

Under the so-called Howey test, an investment contract exists when "a person invests his [or her] money in a common enterprise and is led to expect profits solely from the efforts of the promotor or a third party." [13] The Howey test applies not just to well-known contracts, schemes or transactions, but any business endeavor that meets the elements, regardless of form.[14] If a digital asset meets the definition of a security, it is "Submerged"[15] in the "Belly of the Beast"[16] of the SEC's jurisdiction.

With the emergence and growth of digital assets, it is crucial to determine whether a digital asset is a security in order to assess all rights and responsibilities surrounding the product. To assist industry professionals and potential investors, the staff of the SEC recently published a statement, framework for analysis to determine if a digital asset is an investment contract, and a related no-action letter.[17]

The analysis framework in particular is helpful by providing a step-by-step approach to applying a traditional Howey analysis to a technologically innovative product.

Seagal's alleged actions came even after the SEC put out a public statement cautioning celebrities that they may be unlawfully promoting ICOs without the proper disclosures.[18] By failing to disclose he was compensated by B2G for promoting their offer of securities, Seagal placed himself, from a compliance perspective, "On Deadly Ground." [19]

If other stock promoters fail to learn the lesson of the SEC's action against Seagal, they may find themselves "Under Siege 2." [20]

Analyzing Celebrity Endorsements of Securities

Celebrity endorsements of securities raises potential concerns that investors may be overly swayed by personal feelings for the celebrity. The action against Seagal should not necessarily be used to question if he is "A Good Man" [21] or if he acted within a "Code of Honor." [22] It can be more productively viewed as a lesson that celebrities can easily run afoul of securities regulations that are designed to protect investors.

"Steven Seagal: Lawman" [23] has previously promoted other business ventures, including the aftershave Scent of Action and his namesake energy drink Steven Seagal's Lightning Bolt. However, potential buyers of those products are predominantly deciding if they want to smell like action or move like lightning.

By endorsing B2G, a security, Seagal was advocating for a product that could potentially lose investors their life savings. Before making an "Executive Decision" [24] to purchase a celebrity-endorsed security, investors should conduct a certain level of due diligence on that person's role in the promotion, even if the promoter has "Maximum Conviction" [25] in the investment product itself.

In November 2017, the SEC's Office of Investor Education and Advocacy published an investor alert related to celebrity endorsements. [26]

The SEC's publication warns investors that they should not make investment decisions solely on celebrity endorsements and provides suggested due diligence steps investors can take to become more informed on the investment opportunity being endorsed.

The alert also highlights that celebrities themselves may be victims and are unknowingly promoting a fraudulent scheme. Due to celebrities' influence, combining fraudulent intent with celebrity endorsements can create "The Perfect Weapon"[27] for financial crime.

The SEC's enforcement action against Seagal, aka Steven "Slowhand" Segal,[28] highlights the potential pitfalls of securities compliance within an increasingly technological world. Disclosure obligations, such as Section 17(b), help ensure transparency with complicated digital products and bring the roll of paid promoters out of the darkness and "Into the Sun." [29]

As digital platforms such as Facebook, Twitter and Instagram allow for greater connection between celebrities and potential investors in digital assets, complying with disclosure rules can remind investors that a celebrity may not be independently qualified or substantively knowledgeable when promoting a digital asset, even if the celebrity is a "Mojo Priest." [30]

Failing to comply with market and investor protection rules can result in regulators seeking "True Justice." [31]

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[1] https://www.imdb.com/title/tt0105690/?ref_=nm_fimg_act_53.

[2] See generally, In the Matter of Steven Seagal, Admin Proc. File No. 3-19712 (February 27, 2020), available at <https://www.sec.gov/litigation/admin/2020/33-10760.pdf>.

[3] https://www.imdb.com/title/tt0094602/?ref_=nm_knf_i3.

[4] https://www.imdb.com/title/tt0102614/?ref_=nm_fimg_act_54.

[5] <https://legcounsel.house.gov/Comps/Securities%20Act%20Of%201933.pdf>.

[6] Id.

[7] Admin Proc. File No. 3-19712 at p. 5.

[8] https://www.imdb.com/title/tt0377100/?ref_=nm_fimg_act_38.

[9] https://www.imdb.com/title/tt0196158/?ref_=nm_fimg_act_44.

[10] See e.g. Section 2(a)(1) of the Securities Act of 1933, Section 202(a)(18) of the Investment Advisers Act of 1940, and Section 3(a)(10) of the Securities Exchange Act of 1934.

- [11] https://www.imdb.com/title/tt11161374/?ref_=nm_fimg_act_2.
- [12] See **SEC v. Howey** , 328 U.S. 293 (1946).
- [13] Id. at 298-299.
- [14] Id. at 298.
- [15] https://www.imdb.com/title/tt0416243/?ref_=nm_fimg_act_36.
- [16] https://www.imdb.com/title/tt0357474/?ref_=nm_fimg_act_40.
- [17] <https://www.sec.gov/news/public-statement/statement-framework-investment-contract-analysis-digital-assets>.
- [18] <https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos>.
- [19] https://www.imdb.com/title/tt0110725/?ref_=nm_knf_t1.
- [20] <https://www.imdb.com/title/tt0114781/>.
- [21] https://www.imdb.com/title/tt3480556/?ref_=nm_fimg_act_15.
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- [23] <https://www.imdb.com/title/tt1329291/>.
- [24] https://www.imdb.com/title/tt0116253/?ref_=nm_fimg_act_50.
- [25] https://www.imdb.com/title/tt2119474/?ref_=nm_fimg_act_17.
- [26] https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_celebrity
- [27] https://www.imdb.com/title/tt4616250/?ref_=nm_fimg_act_9.
- [28] https://www.imdb.com/title/tt0196158/?ref_=nm_fimg_act_44.
- [29] https://www.imdb.com/title/tt0358294/?ref_=nm_fimg_prd_32.
- [30] <https://www.allmusic.com/album/mojo-priest-mw0000440877>.
- [31] https://www.imdb.com/title/tt1697033/?ref_=nm_fimg_act_18.