

Q&A

ON THE

SUMMER 2023

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With DAMS, Lawmakers Aim to Set Rules of the Road for Crypto

Introduction

On June 2, House Republicans on the Financial Services and Agriculture Committees jointly released a draft of the Digital Asset Market Structure Act, or “DAMS”. The bill represents one of the most serious attempts so far to create a new regime for digital assets regulation in the United States – and one that might clear the cloud of uncertainty that surrounds cryptocurrencies and other digital assets today. The bill’s introduction by

the current House majority – led by Financial Services Committee Chair Patrick McHenry (R-NC) and Agriculture Committee Chair Glenn Thompson (R-PA) – is especially notable as it comes at a time when the SEC, under the Biden Administration, has adopted a much more aggressive enforcement posture.¹ Against this backdrop, leaders in the digital asset industry have expressed cautious optimism about the bill, with one calling DAMS “a good starting point for a sensible market structure bill”² and another saying that DAMS offers token issuers “a path to compliance.”³ If

1 Leo Schwartz, *Key House committees team up on bill that would provide clarity to crypto markets*, Fortune Crypto, <https://fortune.com/crypto/2023/06/02/key-house-committees-team-up-bill-crypto-markets/> (June 2, 2023).

2 Billy Bambrough, *Congress Introduces A Game-Changing Crypto Bill Amid \$350 Billion Bitcoin, Ethereum, BNB And XRP Price Pump*, Forbes, <https://www.forbes.com/sites/digital-assets/2023/06/05/congress-introduces-a-game-changing-crypto-bill-amid-bitcoin-ethereum-bnb-and-xrp-price-pump/?sh=2d4bec7970f2> (June 2, 2023).

3 Brayden Lindrea, *Republican Crypto Bill a ‘10x Improvement’ On All Others — Messari CEO*, <https://cointelegraph.com/news/republi->

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Regulatory Action

- **SIFMA Raises Concerns Over SEC’s Proposed Rule on DeFi Systems**
On June 14, 2023, the Securities Industry and Financial Markets Association (SIFMA) expressed concern regarding a proposed rule by the U.S. Securities and Exchange Commission (SEC) that could bring certain decentralized finance (DeFi) systems under its purview.

SIFMA submitted comments urging caution regarding the expansion of Regulation ATS, which governs alternative trading systems, arguing that DeFi systems should have separate guidelines. SIFMA pointed out that complying with the proposed regulations could compromise the decentralized nature of DeFi systems.

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passed, DAMS would expand regulatory exemptions, establish new legal definitions, and fill the regulatory and enforcement gap that currently exists between the SEC and the CFTC – the two federal agencies that have been most active in digital assets regulation albeit without clearly defined roles.

Expanded Exemptions For Early-Stage Projects

DAMS is intended to address the difficulty (and, according to many, impracticality) of requiring early-stage token projects to comply with SEC disclosure and registration requirements in connection with token issuing activities. The draft bill would exempt from the existing securities laws any initial coin offering for which total sales of the coin over the previous year were less than \$75 million and as to which purchases by any non-accredited buyer were small as a percentage of token sales or the buyer's net worth.⁴ However, the issuer must meet a "securities lite" set of requirements such as filing certain information with the SEC, including annual and semiannual reports, until after the issuer's network is "certified decentralized."⁵

Entrepreneurs and investors have also at times expressed concern about uncertainty as to potential securities liability for engaging in activities *related* to issuing tokens, like developing blockchain infrastructure or consumer-facing applications, even if they are not issuing tokens themselves. The bill addresses this too by exempting from direct SEC regulation those who offer so-called "ancillary services" like providing a user interface for a blockchain network or, importantly, developing digital asset wallet applications.⁶

The New Middle Ground – Alternative Trading Systems

DAMS takes direct aim at what is considered one of the most vexing problems for digital asset platforms: how to regulate early-stage projects before they mature and become sufficiently decentralized. To solve this, the bill would allow certain platforms to register as Alternative Trading Systems (ATS). This designation – which the SEC could *not* deny to a platform that sought it solely on the basis that the assets traded are digital assets–

would permit a platform to offer restricted digital assets, subject to certain informational disclosure requirements.

Through Decentralization, an Off-Ramp from SEC Regulation

The bill would allow digital asset issuers to demonstrate that a platform associated with a given token is both functional and sufficiently decentralized within the meaning of the act so as to render its token a commodity and not a security – and thus outside the ambit of SEC enforcement. This is meant to address what has been one of the biggest points of contention between the industry and the SEC: whether a project or platform is "far enough along," i.e., operational and distributed such that its tokens are not investment contract securities. Under DAMS, a platform is "functional" when (*inter alia*) the assets on the network are used for transmitting value, interacting with a network application, or participating in the network's governance.⁷ And it is "decentralized" when the initial backers of the project can show they are no longer primarily in control of it: no single entity has exerted unilateral control over the network for the past year; the token issuer (or affiliate) has not owned or exerted voting power in excess of 20% of issued tokens; the issuer has not substantially changed the network's code or marketed the network in the past three months; and all tokens issued in the last year have been created by the system's "programmable functioning."⁸ Given the variety and complexity of digital asset projects, however, it is unclear whether these criteria are specific enough to provide the necessary clarity. It is of course possible that token issuers and the government may have legitimate disputes over what (for example) constitutes "programmable functioning" or what it means to "materially alter" the blockchain network's operation.

A More Robust Role for the CFTC

The bill envisions that the lifecycle of a successful blockchain project culminates in its tokens being traded and used by a widely-distributed network of

[can-crypto-bill-10x-improvement-messari-ceo](#) (June 8, 2023).

4 *Digital Asset Market Structure Discussion Draft*, House Committee on Financial Services and House Committee on Agriculture at p. 2, <https://docs.house.gov/meetings/AG/AG00/20230606/116051/HHRG-118-AG00-20230606-SD001.pdf>.

5 *Id.*

6 *Id.* at 4.

7 Discussion Draft of Digital Assets Market Structure Act, House Committee on Financial Services and House Committee on Agriculture at 10, <https://docs.house.gov/meetings/AG/AG00/20230606/116051/HHRG-118-AG00-20230606-SD003.pdf>.

8 *Id.* at 6.

people. Once a network can certify that it is functional and decentralized pursuant to the definitions detailed above, DAMS generally exempts its tokens from SEC oversight (see discussion, *supra*) and would regulate them not as securities, but as digital commodities. It is at this point where the drafters have elevated the role of the CFTC in supervising blockchain networks and trading markets. The bill would confer “exclusive regulatory jurisdiction” on the CFTC to supervise a newly-defined class of token market participants: digital commodity exchanges (DCEs), digital commodity dealers (DCDs), and digital commodity brokers (DCBs).⁹ And the bill would state that a payment stablecoin should be considered a digital commodity, and thus subject to CFTC jurisdiction.

Each of these entities would be required to register with the CFTC and would have to comply with robust regulatory standards. Digital commodity exchanges would not only have to comply with a long list of CFTC “core principles”; they would only be permitted to list digital commodities that are “not susceptible to manipulation” and for which they have disclosed information about the token’s underlying “source code, transaction history, and digital asset economics.”¹⁰ Similarly, digital commodity brokers and dealers would have to (*inter alia*) comply with business conduct, conflict-of-interest, and fair dealing standards, maintain minimum capital reserves, and segregate customer funds. These provisions, more than anything else, may help to establish a regime of disclosure in digital assets beyond what exists today.

Finally, where appropriate, the CFTC’s regulatory authority is intended to be consistent with that of the SEC. For example, the exemptions that shield “ancillary activities” from direct SEC regulation would be mirrored by exemptions from direct CFTC regulation.¹¹

Improvements in Innovation

The draft bill lays out an ambitious plan for various agencies to conduct rulemaking and market studies and emphasize innovation in their internal processes. It would codify “FinHub” at the SEC and “LabCFTC” at the CFTC, and would charge both with keeping abreast of new fintech technologies, improving industry accessibility to their respective agencies, and providing expertise to agency leadership.¹² Further, the bill would require the two agencies to conduct a joint study on decentralized finance. And non-fungible assets, although not the focus of the legislation, are highlighted as an area of future interest. The draft provides for the Commerce Department, in conjunction with the White House Office of Science and Technology, the SEC, and the CFTC, to study non-fungible assets in preparation for future legislative efforts.¹³

Political Consensus Will Be Hard to Reach

This bill is expected to face pushback from SEC Chair Gary Gensler and House Democrats.¹⁴ SEC Chair Gensler, for one, has repeatedly stated – including in hearings before the House Financial Services Committee itself – that the principal problem with digital assets regulation and enforcement is not a lack of clarity but rather non-compliance by industry players with rules that are already in place.¹⁵ Consistent with this view, on June 5, 2023 – just three days after DAMS was first circulated – the SEC announced a lawsuit against digital currency exchange Binance, accusing it of misrepresenting trading controls and oversight on its platform and engaging in the unregistered sale of securities.¹⁶ It followed that with another suit against Coinbase the very next day, alleging that the company operates as an unregistered securities exchange, broker, and clearinghouse.¹⁷ These lawsuits make clear that the

9 Digital Asset Market Structure Discussion Draft at 4, House Committee on Financial Services & House Committee on Agriculture, <https://docs.house.gov/meetings/AG/AG00/20230606/116051/HHRG-118-AG00-20230606-SD001.pdf>.

10 *Id.* at 5.

11 *Id.*

12 *Id.* at 6.

13 *Id.* at 7.

14 Allyson Versprille, *Key House Republicans Unveil Crypto Market Structure Draft Bill*, Bloomberg law, https://www.bloomberglaw.com/bloomberglawnews/crypto/X7CMG0IK000000?bna_news_filter=crypto#jcite (June 2, 2023).

15 Oluwapelumi Adejumo, *SEC Chair Gensler Highlights Crypto Firms Non-Compliance In House Committee Testimony*, CryptoSlate, <https://cryptoslate.com/sec-chair-gensler-highlights-crypto-firms-non-compliance-in-house-committee-testimony/> (April 18, 2023).

16 *SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao*, Securities and Exchange Commission, <https://www.sec.gov/news/press-release/2023-101> (June 5, 2023).

17 *SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency*, Securities and Exchange Commission, <https://www.sec.gov/news/press-release/2023-102> (June 6, 2023).

SEC’s adversarial approach to the digital assets industry may be very different from that of DAMS’s sponsors.¹⁸

Perhaps unsurprisingly, congressional Democrats have expressed skepticism, if not outright hostility, to the DAMS proposal. Rep. Maxine Waters (D-CA), ranking member of the Financial Services Committee, criticized some of the bill’s provisional registration provisions as a “get out [of] jail free” card for firms engaging in illegal or unethical behavior.¹⁹ Others, like Stephen Lynch (D-MA) and Brad Sherman (D-CA), both Financial Services Committee members, accused DAMS of undermining the SEC and a giveaway to the crypto industry.²⁰

And other commentators have already begun raising substantive concerns. Pointing to the bill’s proposed requirements for decentralized networks, one firm points out that prohibiting software changes by a platform operator could have the effect of discouraging necessary changes.²¹ An op-ed in widely-read crypto industry publication *Cointelegraph* describes the bill as “watershed draft legislation” but states that it “falls short of bringing regulatory clarity to the industry.”²² It concludes that, given the bill’s standards for functionality and decentralization, “protocols with any level of centralized operations (read: most) remain under the jurisdiction of the Securities and Exchange

18 Zachary Warmbrodt, Eleanor Mueller and Declan Harty, *Biden’s crypto cop taunts Republicans*, Politico, <https://www.politico.com/news/2023/06/06/bidens-crypto-cop-taunts-republicans-00100412> (June 6, 2023).

19 Nicholas Morgan, *Crypto Leaders Praise Draft GOP Bill, Dems Raise Concerns*, Decrypt, <https://decrypt.co/144663/crypto-leaders-praise-draft-gop-bill-dems-raise-concerns> (June 14, 2023).

20 *Id.*

21 Jonathan E. Schmalfeld, Stephen A. Rutenberg, Majer Ma, *Proposed Digital Asset Market Structure Bill Could Give Regulatory Clarity; But is it the Regulatory Clarity the Industry Wants?*, Polsinelli, <https://www.polsinellibitblog.com/new-blog/2023/6/9/proposed-digital-asset-market-structure-bill-could-give-regulatory-clarity-but-is-it-the-regulatory-clarity-the-industry-wants> (June 9, 2023).

22 Alex, O’Donnell, *Opinion: GOP Crypto Maxis Almost As Bad As Dems’ ‘Anti-Crypto Army’*, Magazine by Cointelegraph, <https://cointelegraph.com/magazine/opinion-republican-crypto-maxis-democrat-anti-crypto-army-mchenry-warren/> (June 15, 2023).

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- finance (DeFi) systems under its purview. SIFMA submitted comments urging caution regarding the expansion of Regulation ATS, which governs alternative trading systems, arguing that DeFi systems should have separate guidelines. SIFMA pointed out that complying with the proposed regulations could compromise the decentralized nature of DeFi systems.

- Ripple Claims Hinman Was Warned About Speech Confusion in SEC Lawsuit**

In a June 13, 2023 filing, Ripple Labs, in its ongoing lawsuit with the SEC, alleged that ex-SEC director William Hinman was advised against the potential confusion his speech on crypto might create. Ripple pointed to internal SEC communications suggesting concerns over certain statements conflicting with the agency’s stance. Ripple argues that the ambiguity from Hinman’s speech and the SEC’s varying interpretations of it contributed to the agency’s enforcement case against them. The SEC has not commented on these allegations. The case continues in the Southern District of New York.
- CFTC Declares Victory in Ooki DAO Litigation**

On June 9, 2023, the U.S. Commodity Futures Trading Commission (CFTC) declared victory in the Ooki DAO litigation after U.S. District Judge William H. Orrick issued a default judgment order requiring Ooki DAO, a decentralized autonomous organization accused of operating an illegal trading platform and unlawfully acting as a futures commission merchant, to pay a civil monetary penalty of \$643,542. The court affirmed that the Ooki DAO qualifies as a “person” under the Commodity Exchange Act and is liable for violations. The order requires the shutdown of Ooki DAO’s website and permanent trading and registration bans.
 - SEC Alleges Coinbase Operating as Unregistered Securities Exchange in Lawsuit**

On June 6, 2023, in a five-count complaint, the SEC alleged Coinbase, Inc. is operating its crypto asset trading platform as an unregistered national securities exchange, broker, and

clearing agency. The SEC also alleges Coinbase's crypto asset staking-as-a-service program amounts to the offer and sale of unregistered securities. The complaint further highlights 13 crypto tokens in particular as tokens the SEC alleges are being traded on Coinbase in unregistered securities transactions. Many commentators have opined that, should the SEC prevail in its suit, centralized U.S.-based crypto exchanges may face significant challenges to operate without new legislation or SEC approval. Coinbase vigorously denies the allegations, as evidenced by its recent petition to the 3rd Circuit Court, compelling the SEC to respond to its rulemaking petition for digital assets. The company maintains that the SEC's delayed response is untenable and calls for urgent transparency and a clearer regulatory framework for the cryptocurrency industry.

- SEC Alleges Binance Operating as Unregistered Securities Exchange in Lawsuit**
 On June 5, 2023, the SEC filed a 13-count complaint against Binance Holdings Ltd., its U.S.-based affiliate BAM Trading Services Inc., and their founder, Changpeng Zhao, alleging multiple securities law violations. The SEC alleges Binance is operating as an unregistered national securities exchange, broker-dealer, and clearing agency, and engaging in the unregistered offer and sale of securities. The SEC alleges that despite public claims of restricted access for U.S. customers on Binance.com, Zhao and Binance allowed high-value U.S. customers to continue trading. The SEC further claims that Binance controlled operations of the Binance.US platform. The complaint contains a list of 12 particular tokens that the SEC alleges are being traded on Binance in unregistered securities transactions. On June 16, 2023, U.S. District Court Judge Amy Berman Jackson approved a stipulation and consent order, agreed to by Binance and the SEC after two days of mediation, allowing Binance.US to continue operations and ensuring U.S. customers' assets remain in the country.
- SEC Proposes Settlements in Crypto Insider Trading Case**
 On May 30, 2023, the SEC unveiled proposed settlements in its first crypto insider trading case involving former Coinbase product manager Ishan Wahi and his brother, Nikhil. In a parallel criminal action, Ishan and Nikhil each pled guilty

and were sentenced to 24 and 10 months in prison, respectively, and were ordered to disgorge all ill-gotten gains. The SEC settlement proposals, which await approval from U.S. District Judge Tana Lin, require no further disgorgement but bar the Wahis from denying the SEC's allegations of insider trading. A friend implicated in the case, Sameer Ramani, remains at large. The proposed settlements do not address whether any of the tokens traded are securities.

- Gemini and Genesis File Motions to Dismiss SEC Claims Over Gemini Earn**
 On May 26, 2023, crypto exchange Gemini Trust Co. and bankrupt crypto lender Genesis Global Capital LLC filed motions to dismiss SEC claims that their investment program, Gemini Earn, violated securities laws. The companies argued that the program's contracts were simple lending arrangements, not unregistered securities, and that the SEC case is complicating the process of returning funds to investors. The SEC had claimed that the loan agreements outlining the service's terms constituted investment contracts, but Genesis argued that the payout was determined by a reliable, disclosed interest rate, not tied to Genesis or Gemini's business performance. Genesis also contended that Earn customers did not share in any risk or potential profits beyond a predetermined amount, hence the agreements did not constitute a "common enterprise" under the *Howey* test.

Civil Litigation

- Kim Kardashian Must Face Investor Suit Over Crypto Promos**
 On May 30, 2023, U.S. District Court Judge Michael Fitzgerald ruled, that a proposed class action suit accusing Kim Kardashian of defrauding investors through her promotion of the EthereumMax token can proceed. The lawsuit, which also names other celebrities as defendants, alleges that Kardashian and others made misleading statements promoting the project in what the investors allege was a "pump-and-dump" scheme. Despite previous dismissals of the case due to inadequate allegations, Judge Fitzgerald found that the investors' latest complaint provides sufficient detail. The ruling allows most allegations in the amended complaint to advance, with the judge granting requests to block certain

claims under California’s Securities Law, pending further amendments to the complaint.

• **Media Heiress Says Crypto Project Scammed Her Out Of \$43M**

On June 13, 2023, Taylor Thomson, billionaire media heiress and member of the Thomson Reuters family, filed a complaint against Persistence Technologies and its CEO, Tushar Aggarwal, alleging a fraudulent scheme involving the unregistered crypto token XPRT which caused her to lose \$43 million of her investment. The lawsuit, filed in a California federal court, accuses Aggarwal and co-defendant Ashley Richardson of inducing Thomson to invest through false promises of returns and then manipulating her investment to mislead other investors. Thomson asserts that XPRT is an unregistered security based on the Howey test and is seeking compensatory damages of at least \$24.7 million, plus punitive damages and the rescission of her token purchases.

• **Class Action Lawsuit Against PoolTogether Dismissed Due to Lack of Standing**

On June 7, 2023, a putative class action lawsuit filed against decentralized finance (DeFi) startup PoolTogether in Eastern District of New York in October 2021, was dismissed after the court found the plaintiff, former congressional staffer Joe Kent, lacked standing due to a failure to prove an injury in fact, despite genuine concerns about PoolTogether’s legality under New York law. PoolTogether responded to the lawsuit by launching an NFT collection called “Pooly” to raise funds for the case in 2022, ultimately raising \$1.4 million for its defense costs.

Bankruptcy Litigation

• **Bittrex Granted Court Approval for Repayment Plan**

On June 15, the U.S. arm of the Bittrex cryptocurrency exchange will resume customer withdrawals after receiving court approval for its repayment plan. The court order allows customers with undisputed claims to withdraw their funds in cryptocurrency or fiat. However, the court’s decision was careful to state that it does not set a precedent for other bankruptcy cases or determine the priority between the firm’s creditors and customers in asset ownership and repayment.

In addition to its customer obligations, Bittrex separately owes nearly \$28 million collectively in fines to the Office of Foreign Assets Control (OFAC) and the Financial Crimes Enforcement Network (FinCEN).

• **Celsius Submits Updated Bankruptcy Plan Post Fahrenheit Asset Bid**

On June 15, 2023, Defunct crypto lender Celsius has submitted an updated bankruptcy plan following the successful asset bid by the Fahrenheit consortium. The proposed plan requires approval from the New York bankruptcy court overseeing the wind-up. Under the Fahrenheit agreement, the new company is set to receive \$450 to \$500 million in liquid cryptocurrency, while US Bitcoin Corp will develop various crypto mining facilities, including a 100-megawatt plant.

Criminal Litigation

• **FTX loses bid for documents from Fenwick & West**

On June 23, 2023, Judge Lewis Kaplan denied a subpoena request from Sam Bankman-Fried, the founder of FTX and Alameda Research, in a written order that labelled the request a “fishing expedition.” The request, filed on May 30, 2023, sought access to documents tied to the legal advice that Fenwick & West provided during the establishment of FTX and Alameda, which Bankman-Fried claimed were vital to his defense. The ruling followed a successful motion by the FTX debtors to intervene, as the requested records were likely shielded by the attorney-client privilege held by the bankrupt FTX.

• **Trial Date Set for Former Billionaire Crypto Founder Guo Wengui**

Former billionaire crypto founder Guo Wengui’s trial for an alleged \$1 billion fraud scheme has been set for April 8, 2024. Wengui allegedly raised \$262 million from the Himalaya Exchange, a purported cryptocurrency ecosystem that included the alleged stablecoin Himalaya Dollar and trading coin Himalaya Coin. The SEC alleges that Wengui raised hundreds of millions of dollars from investors in Himalaya Coin by falsely stating that 20% of the coin’s value was backed by gold and that he would personally compensate investors for any potential losses.

- **Senators Call for DOJ Investigation of Binance Holdings Ltd.**

On June 8, 2023, in an open letter, U.S. Senators Elizabeth Warren and Chris Van Hollen urged Attorney General Merrick Garland to probe Binance and Binance.US regarding their compliance practices and company structure statements made to Congress in March. They argue that despite Binance CEO Changpeng Zhao's ownership in both entities, the companies insisted they operated independently. The complaint filed by the SEC alleges a close relationship between the two entities, contradicting their claims of separation. The senators accuse Binance and Binance.US of providing misleading information to Congress, thereby undermining a bipartisan investigation and legislative process.

progress on bipartisan stablecoin legislation. Despite interest in the bill, differing views persist on issues such as the role of non-bank entities in issuing tokens and the extent of state regulator autonomy under a federal proposal. There is agreement on both sides for foundational consumer protection, capital requirements, and oversight for stablecoin issuers, regardless of trust charters. Differences primarily lie in choosing a regulator, determining regulatory and enforcement aspects, and deciding on the role of state oversight in the regulatory regime.

Regulatory and Policy Developments

- **Congressional Hearing Analyzes Regulatory Challenges and Future of Digital Assets**

On May 5, 2023, the Committee on Financial Services and Agriculture released a memo titled "The Future of Digital Assets: Closing the Regulatory Gaps in the Digital Asset Ecosystem." Various industry representatives testified at a subsequent hearing that centered on the challenges of classifying digital assets as either securities or commodities under U.S. law. The memo underscored ambiguity in the current regulatory framework, which has prompted market participants, consumers, and investors to seek clarity.

- **CFTC Issues Staff Advisory on the Risks Linked to Clearing of Digital Assets**

On May 30, 2023, the CFTC's Division of Clearing and Risk (DCR) issued a letter (No. 23-07) to all DCR registrants and applicants, stressing the need to identify and mitigate potential risks linked to digital asset clearing expansion. Highlighting system safeguards, physical settlement procedures, and conflicts of interest, the DCR emphasized managing cyber and operational risks, minimizing conflicts of interest, and ensuring appropriate management of obligations linked to digital asset delivery.

- **Congressional Gridlock Slows Progress Stablecoin Bill Progress**

On May 18, 2023, lawmakers discussed current

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