PiperAlderman

Article Information

Authors: Michael Bacina, Steven Pettigrove, Luke Higgins
Service: Blockchain, Corporate & Commercial
Sector: Financial Services

Federal Court: Block Earner dodges the chopping block and ASIC criticised for misleading media release

Michael Bacina, Steven Pettigrove & Luke Higgins of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

In a closely anticipated decision, the Federal Court has absolved Block Earner from civil penalties in relation to its offer of Earner, a centralised fixed rate yield product.[1] The Federal Court had previously found the Earner product was a managed investment scheme and financial investment, and that Block Earner had engaged in carrying on an unlicensed financial service by offering the product prior to it being withdrawn in November 2023.[2]

Background

ASIC first commenced proceedings against Block Earner in November 2022 despite the Earner product already having been withdrawn, alleging that both of Block Earner's Earner and Access products (the latter being a DeFi pass-through yield product) were financial products offered without an Australian Financial Services Licence (**AFSL**).

On 9 February 2024, the Federal Court ruled that the Access product was not a financial product, but the Earner product was. This meant that between March and November 2022, Block Earner had offered unlicensed financial services and operated an unregistered managed investment scheme through its Earner product. The parties were invited to make submissions on an appropriate penalty for Block Earner's contravention. ASIC sought a pecuniary penalty of AUD $350,000, whereas Block Earner argued that it should be entirely relieved from penalties by virtue of section 1317S of the *Corporations Act 2001* (Cth) (**Corporations Act**), and in the alternative argued the penalty should be AUD $60,000. Subsection 1317S(2) states that:

> ***Section 1317S – Relief from liability for contravention of civil penalty provision***
>
> *(2) If:*
>
> > *(a) eligible proceedings are brought against a person; and*
> >
> > *(b) in the proceedings it appears to the court that the person has, or may have, contravened a civil penalty provision but that:*
> >
> > > *(i) the person has acted honestly; and*
> > >
> > > *(ii) having regard to all the circumstances of the case (including, where applicable, those connected with the person's appointment as an officer, or employment as an employee, of a corporation or of a Part 5.7 body), the person ought fairly to be excused for the contravention;*
>
> *the court may relieve the person either wholly or partly from a liability to which the person would otherwise be subject, or that might otherwise be imposed on the person, because of the contravention.*

Section 1317S effectively operates as a "safety net" for honest mistakes. If a person/entity contravenes a *civil* penalty

provision of the Corporations Act, but is found to have acted honestly and fairly in the circumstances, a court has the power to excuse them from a penalty despite a finding that they had breached the Corporations Act. This includes officers or employees of corporations who may have contravened rules but acted in good faith in doing so. This section operates similarly to section 183 of the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act), which applies to credit providers. Section 183 of the NCCP Act provides that if proceedings are brought against a person and it appears to the court that the person has contravened a civil penalty provision of the NCCP Act but acted honestly, then the court may relieve that person either wholly or partly from a pecuniary penalty.

Analysis of the decision

His Honour Justice Jackman found that Block Earner had not been "*careless or imprudent*" to any degree as it made a genuine attempt to comply with the requirements of the Corporations Act, despite ASIC's contentions to the contrary (at [12]).

The Court noted that Block Earner had formed an "*unchallenged view*", after "*obtaining legal advice from a leading law firm*", that there was no identified risk that the Earner product would breach any laws or regulations (at [14]).

Block Earner submitted that it effectively did the best that any reasonable business could do in Australia's uncertain financial services regulatory environment (at [17]-[19]). His Honour highlighted an extract from a recent Australian Law Reform Commission report, titled "Confronting Complexity: Reforming Corporations and Financial Services Legislation", which stated on its first page:

> *[T]he legislation governing Australia's financial services industry is a tangled mess – difficult to navigate, costly to comply with, and unnecessarily difficult to enforce.*
>
> *Judges have described the current laws as being like "porridge", "tortuous", "treacherous", and "labyrinthine".*

Block Earner had received adverse media coverage as a result of the 9 February 2024 decision that had affected its legitimate and lawful business. In particular, his Honour accepted a complaint by Block Earner that a media release published by ASIC the same day as the judgment, titled "Court finds Block Earner crypto product needs financial services licence", was unfair and misleading for reasons including that Block Earner did not "need" an AFSL as at 9 February 2024, as the Earner product had been withdrawn in November 2022.

Block Earner gave evidence that ASIC's media release, and the news articles that took inspiration from the release, would likely have "devastating business and reputational consequences" for Block Earner (at [20]-[27]). The title of ASIC's media release has since been changed to use the past tense.

ASIC has released a media statement following the recent decision, which states that:

> *[e]ntities providing services in relation to crypto-related products should be aware many such products are financial products. ASIC Information Sheet 225: Crypto Assets provides guidance on the circumstances in which a crypto-related offering may be a financial product.*

ASIC's Information Sheet 225 (**INFO 225**), being the only crypto-asset specific piece of guidance from the regulator currently in existence, aims to help businesses operating in the space to understand their obligations under the Corporations Act. INFO 225 states that businesses operating in the space should seek early legal advice from qualified firms. Ironically, that is precisely what Block Earner did, only to be later sued by the regulator.

Turning back to the decision at hand, his Honour accepted that Block Earner's active participation in policy discussions with key industry participants and regulators concerning crypto-asset products supported a finding that Block Earner had sought to conduct its business in a lawful manner (at [29]).

Despite ASIC's contention that there was no explicit evidence that legal advice prepared for Block Earner was actually relied upon by it or specifically drafted in relation to its Earner product, his Honour found there was an "obvious inference" for which the legal advice was obtained (at [33]).

His Honour rejected a submission from ASIC that granting Block Earner relief from liability would send a message to the industry that it need not rigorously evaluate whether offerings were regulated financial products and that the uncertainty inherent in a lay person's understanding of the Corporations Act may give rise to a successful defence by virtue of honesty

and misapplication of complex laws (at [35]).

Instead, his Honour found that the *contrary* was likely true, and that the complexity and uncertainty of this area of law (at [35]):

> *…heightens the imperative that such [businesses] obtain legal advice from experienced and competent lawyers before launching their products and services.*

His Honour concluded that, subject to the circumstances of the case, a person or business who:

1. understands there is legal uncertainty in their proposed course of conduct, and
2. takes the time to obtain legal advice from a qualified person, and
3. then genuinely concludes that there is no identified risk of breaching the law,

ought fairly to be excused from liability if such proposed conduct happens to be a breach of a civil penalty provision of the Corporations Act (at [39]). He noted that the analysis may be different where the person concludes that the:

> *…conduct is probably lawful but the question is relatively finely balanced and carries a substantial risk of contravention, or where the person derives a substantial profit or causes substantial harm by virtue of the contravention.*

Despite the importance of the provisions breached by Block Earner (at [43]), his Honour found that Block Earner should be relieved from liability for a pecuniary penalty, and even if he was to not grant relief, no penalty would have been ordered (at [47]).

Cost orders

In finding that ASIC had essentially won half of its initial claim and lost half of its initial claim, his Honour ordered that the parties were to bear their own costs up to the date of the decision relating to Block Earner's contravention of the Corporations Act (9 February 2024). ASIC was then ordered to pay Block Earner's costs *after* 9 February (including for the penalty hearing decision) and his Honour again called out ASIC's misleading media release as a factor in that decision, but also that he would have ordered costs against ASIC even in absence the media release (at [84]).

Conclusion

While the decision will likely be seen as supportive of the crypto industry, and highlight ways in which projects can seek to protect themselves when operating in an uncertain environment, it is better to not be the subject of litigation in the first place. Indeed, it was evident from the judgment that Block Earner had incurred substantial legal costs in defending the proceedings.

The intricate and evolving nature of financial services laws and their application, particularly when it comes to emerging technologies like blockchain gives room for an approach like Justice Jackman's decision to waive Block Earner's potentially significant penalties, despite acknowledging the severity of its contraventions under the Corporations Act. This underscores the importance of obtaining early legal advice from qualified, specialist crypto lawyers before launching products or businesses.

The case also highlights that even in an uncertain regulatory environment like Australia, businesses *must* make a genuine attempt to comply with the requirements of the Corporations Act. If a business obtains legal advice and genuinely concludes that there is no identified risk of breaching certain laws, there may be grounds to argue that it should be excused from heavy fines if such conduct is later found to be in breach of a civil penalty provision of the Corporations Act.

[1] *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd (Penalty)* [2024] FCA 578

[2] *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* [2024] FCA 64