

IN MATTER OF FIRST IMPRESSION, DELAWARE SUPERIOR COURT CALCULATES VALUE OF CRYPTOCURRENCY FOR \$25 MILLION DAMAGES AWARD

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BACKGROUND

This month, the Delaware Superior Court's Complex Commercial Litigation Division answered a novel question in Delaware law: "When the consideration to be paid on a contract is in cryptocurrency and the contract is breached, how does the Court calculate the judgment to be entered?"¹ Noting that such issues are "novel matters to Delaware," Judge Paul R. Wallace, as a matter of first impression, pinned down the value of a normally fluid cryptocurrency and awarded US\$25 million in damages for breach of contract.²

ANALYSIS

In *Diamond Fortress Technologies Inc. v. EverID Inc.*, Defendant EverID, Inc. (EverID) failed to compensate plaintiffs, Diamond Fortress Technologies, Inc. (Diamond Fortress) and its CEO Charles Hatcher II, for their work in helping develop EverID's cryptocurrency trading platform.

Diamond Fortress is a biometric software company that developed software to allow smartphone cameras to detect and verify a user by fingerprint recognition. EverID is an entity active in the blockchain and cryptocurrency industry. It created a cryptocurrency called "ID tokens." EverID licensed Diamond Fortress's software to be integrated into EverID's cryptocurrency platform in order to verify and confirm users' identities. EverID also retained Mr. Hatcher to serve as an advisor for the integration process. Under the terms of the licensing agreement, Diamond Fortress was to receive 10 million ID tokens and Mr. Hatcher was to receive 2.5 million. Both parties were to receive the ID tokens after its initial coin offering (ICO).³

The ICO occurred on 8 February 2021. EverID, however, failed to tender payment. Diamond Fortress attempted to contact EverID several times between 8 February and 4 March, but it received no response. Diamond Fortress and Mr. Hatcher then filed suit for breach of contract. EverID never responded to the complaint or otherwise defended itself, and plaintiffs sought a default judgment.

As Judge Wallace noted, the otherwise straightforward breach-of-contract case posed novel issues: What is the remedy when the consideration is a new cryptocurrency with a "volatile and unregulated" value,⁴ and in calculating that value, should the court classify that cryptocurrency as a "security/investment contract, a commodity, property, or currency?"⁵

First, the court noted that other “[c]ourts commonly classify a cryptocurrency as a security when the economic harm directly relates to or arises from its ICO.”⁶ Here, the court concluded, EverID’s failure to distribute the ID tokens on the date of the ICO was the direct cause of plaintiffs’ injury.⁷ The court further noted that the licensing agreement provided that distributions were subject to regulatory compliance under Rule 144 of the Securities Exchange Act of 1933. Therefore, the court viewed the ID tokens in these circumstances as a security.

Next, the court was required to find a reliable source of cryptocurrency valuations to determine the value of the ID tokens. The court noted that other courts have used CoinMarketCap as a reliable valuation tool for determining the value of cryptocurrency tokens and that *The Wall Street Journal* and the *Financial Times* also use CoinMarketCap to report the prices of virtual currencies.

Finally, the court was required to determine the proper method for calculating the damages such that it would place plaintiffs in the same position they would have been had the licensing agreement been fully performed. The court noted that in analogous “failure to deliver securities” cases, Delaware courts calculate damages by determining “the highest market price of the security within a reasonable time of a plaintiff’s discovery of the breach.”⁸ The court determined that the three-month period from 4 March 2021 to 3 June 2021 was a “reasonable time.” According to CoinMarketCap, the highest market price of ID tokens between 4 March and 3 June was US\$2.01.

Therefore, using this analysis, the court calculated damages for Diamond Fortress’s 10 million ID tokens to be US\$20,100,000 and damages for Mr. Hatcher’s 2.5 million ID tokens to be US\$5,025,000.

KEY TAKEAWAYS

As Judge Wallace remarked, “[b]ut for the novelty of the subject instrument being units of cryptocurrency this suit mirrors any other failure to deliver securities case—a run-of-the-mill action for Delaware courts.”⁹ The court’s decision—in which Judge Wallace noted “the lack of regulatory policy of cryptocurrency” was “on full display”—was reached as Congress is considering the Digital Asset Market Structure and Investor Protection Act, which would regulate digital assets and digital asset securities. The U.S. Securities and Exchange Commission and the Commodity Futures Trading Commission would be required to issue a proposed rulemaking within 150 days after the bill’s enactment classifying major digital assets by either their highest market capitalization or highest daily trading volume. The legislation, Judge Wallace also observed, referred both federal agencies to CoinMarketCap as an appropriate public source for data on digital assets.

The decision reflects the proliferation of digital assets, cryptocurrencies, and other applications supported by blockchain technology and provides meaningful guidance for how courts will value cryptocurrencies when tasked with calculating a damages award.

FOOTNOTES

¹ *Diamond Fortress Techs. Inc. v. EverID Inc.*, C.A. N21C-05-048-PRW-CCLD (Apr. 14, 2022).

² *Id.*

³ As explained by the court, an ICO occurs when “a new species of cryptocurrency token is issued in exchange for fiat or already circulating virtual currencies to raise capital.” *Id.* at 12.

⁴ *Id.* at 30.

⁵ *Id.* at 14.

⁶ *Id.* at 23 (citing *U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc.*, 492 F. Supp. 3d 169 (S.D.N.Y. 2020)).

⁷ *Id.* at 24.

⁸ *Id.* at 32 (citing *Am. Gen. Corp. v. Cont'l Airlines Corp.*, 622 A.2d 1 (Del. Ch. 1992)).

⁹ *Id.* at 32–33.

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