



Securities Litigation ADVISORY ■

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Cryptocurrency Securities Class Action Suits: Paving the Path for U.S. Jurisdiction

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Recently, in *In re Tezos Securities Litigation*, a securities class action arising from the unregistered initial coin offering of a new digital currency called Tezos tokens, a California district court denied motions to dismiss for lack of personal jurisdiction, forum non conveniens, and the *Morrison* doctrine limiting the extraterritorial application of the federal securities laws.¹ The *Tezos* court's application of the familiar tests and factors that govern these threshold jurisdictional issues to the digital realm may help set the stage for other groups of ICO participants to establish jurisdiction for securities class action claims relating to cryptocurrency offerings in federal courts across the country.

What Is an Initial Coin Offering?

An initial coin offering (ICO) has become a prevalent, and indeed preferred, means to raise funds for digital currency and cryptocurrency ventures (e.g., Bitcoin, Ethereum, and the like). The perceived virtue of ICOs has been that the offering sponsors can bypass the rigorous and highly regulated capital-raising process required by the federal securities laws, as well as the attendant litigation risk. Notably, the U.S. Securities and Exchange Commission (SEC) only recently determined in a July 2017 release that a virtual coin or token may be subject to federal securities laws.² It is notable, therefore, that in their initial motions to dismiss, the defendants in this case did not even raise the argument that the Tezos tokens being offered here were not securities.

¹ The defendants also moved to dismiss for failure to state claims upon which relief can be granted.

² The SEC first offered guidance on whether a token is a security, and found that it was, in its July 25, 2017 Release No. 81207, "[Report of Investigation Pursuant to Section 21\(a\) of the Securities Exchange Act of 1934: The DAO](#)." Before this, in 2015, the Commodity Futures Trading Commission (CFTC) announced that Bitcoin and other virtual currencies are properly defined as commodities. The [CFTC maintains](#) that its "jurisdiction is implicated when a virtual currency is used in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce." See October 17, 2017 presentation entitled "A CFTC Primer on Virtual Currencies." Available at: https://www.cftc.gov/sites/default/files/idc/groups/public/%40customerprotection/documents/file/labcftc_primercryptocurrencies100417.pdf. Unless the CFTC has reason to believe fraud or manipulation is involved, the CFTC generally does focus on "spot" or cash market exchanges and transactions involving virtual currencies not utilizing leverage of some kind.

Personal Jurisdiction over Foreign Entities

The class action complaint was brought against California residents Arthur Breitman, Kathleen Breitman, and their company Dynamic Ledger Solutions; the Tezos Foundation (“Foundation”), a nonprofit based in Switzerland established by the Breitmans to oversee the ICO at issue; and Bitcoin Suisse, a foreign firm specializing in the crypto-financial sector that provided intermediary services to certain individual ICO contributors.³

As to Bitcoin Suisse, the court found that the plaintiff failed to allege or submit specific facts showing that Bitcoin Suisse actually provided services to any U.S. participant, even though Bitcoin Suisse contracted with the Foundation.

As to the Foundation, the court acknowledged that, per Ninth Circuit case law, the mere fact that the tezos.com website was hosted on an Arizona server, was freely accessible to U.S. citizens, and was highly interactive, was in and of itself inadequate to establish personal jurisdiction. However, the court went on to conclude that the fact that the Foundation had one employee or agent in the U.S. was sufficient for purposes of specific personal jurisdiction. The court then noted that the complaint did much more than the minimum by alleging that the Foundation encouraged U.S. citizens to participate in the ICO and made it easy for them to do so, which resulted in U.S. citizens representing a significant portion of the 30,000 contributors to the ICO. The court also considered that the Breitmans functioned as the U.S. marketing arm and that the Foundation made little or no marketing effort outside the U.S. And finally, the court focused on the Foundation’s decision to build an English-language, U.S.-hosted website and structure an ICO to accommodate U.S.-based participation as additional indicia of the Foundation’s forum-related contacts.

Forum non Conveniens

The Foundation then argued that the case should be dismissed on forum non conveniens grounds because there was a forum selection clause in the ICO contribution terms referenced on the tezos.com website, which provided that Switzerland would be the location for all Tezos-related litigation. The judge determined this clause should not control because it appeared in a single sentence on the tenth page of a 20-page “browsewrap” agreement to which users were directed by an oblique reference to a “legal document” without any hyperlink provided on the tezos.com website. Browsewrap agreements refer to terms and conditions to which a website attempts to bind its users by inferring affirmative assent, as distinguished from “clickwrap” agreements, which ask users to actually engage with the website, by clicking a box for example, to affirmatively show knowledge and consent. The court ruled that there was no allegation or evidence offered that the website put users on inquiry notice of the terms of the contract. Interestingly though, the court left open the possibility that evidence of the plaintiff’s actual knowledge of the agreement may provide a way to revive the ICO contribution terms clause and enforce it at a later stage of the case.

Extraterritorial Application of the Federal Securities Laws

Since the landmark decision in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), which set forth the “bedrock principle” against extraterritorial application of the U.S. securities laws without express congressional authority, courts have struggled to apply the contours of the *Morrison* opinion in securities cases involving foreign issuers and entities domiciled outside the U.S.

³ The court’s opinion incorrectly states that the complaint’s Section 12 and Section 15 claims are sections of the Securities Exchange Act of 1934; they are in fact sections of the Securities Act of 1933.

In *Tezos*, the defendants argued that *Morrison* requires that, in order for the federal securities laws to reach transactions in a security not listed on an American stock exchange, the sale transaction itself must have been domestic. In this case, the Foundation, based in Switzerland, again tried to invoke the contribution terms to argue that the contractual situs of the transaction was not domestic and that the contribution and allocation took place in Europe. The defendants further argued that the Foundation's contribution software that actually effected the transaction was located outside the U.S. and that it was less important where *tezos.com* was hosted.

The court disagreed, noting that the browsewrap terms were of little significance and instead the inquiry should be: where does the *actual*, not contractual, situs of buying an unregistered security, purchased on the Internet, and recorded "on the blockchain" take place? In finding that the plaintiff's transaction had a sufficient nexus to the U.S. to qualify as a domestic transaction, the court looked to the "realities of the transaction," which included the following: (1) the plaintiff participated in the transaction in the U.S.; (2) the plaintiff accessed a website hosted on a server in California, run by Arthur Breitman in California; (3) the plaintiff learned about the ICO and participated in response to marketing efforts targeted at U.S. citizens; and (4) the plaintiff's contribution to the ICO became irrevocable and was validated by a network of global "nodes" clustered more heavily in the U.S. than in any other country.

Conclusion

These rulings in the *Tezos* case present a relatively novel application of traditional threshold jurisdictional principles to the new world of digital offerings and transactions between U.S. residents and foreigners. By going beyond the form of the transaction and the superficial factors of citizenship or domicile, the court's analysis provides insights for both ICO sponsors and participants into the factors and circumstances that may be critical in the determination of whether a particular ICO transaction can become the subject of a U.S. federal securities lawsuit.

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