SEC v. Telegram: A Global Message

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Abstract

On Thursday January 7, 2021, the total market capitalization of cryptocurrencies exceeded $1 trillion USD, and by early April 2021 the total exceeded $2 trillion. While Bitcoin accounts for most of these amounts, the significance of this milestone is hard to overstate. The exponential growth of the crypto market, at a minimum, signals increasing acceptance of the new asset class by a growing number of investors. At the same time, however, U.S. regulators not only continue to be aggressively hostile to crypto, the Securities and Exchange Commission (SEC), in particular, has successfully pushed to have its approach imposed world-wide.

On April 1, 2020, the SEC won a remarkable victory in its case against Telegram Group Inc., a social media company domiciled in the United Kingdom and headquartered in the United Arab Emirates, obtaining a global injunction against the planned issuance of a new cryptoasset that would have been called Grams. Despite the fact that a majority of the early investors were located outside the U.S. and in the face of offers from the company to refund the purchase price to American investors and direct all future efforts at overseas investors, a judge in the Southern District of New York imposed a global ban on the future sale of Grams, leading Telegram to discontinue its entire offering.

This Article questions both whether this result was necessary under existing precedents applying U.S. securities laws to sales to noncitizens located elsewhere in the world and whether, assuming the

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result was legally proper, it is a desirable outcome. After considering the potential benefits and disadvantages of a global enforcement approach in the context of cryptoassets and transactions, this Article suggests a range of potential alternatives to the result reached in SEC v. Telegram*.*

I. INTRODUCTION

At no point has the potential for crypto development been stronger. In little more than a decade, the world has moved from a theoretical idea in a pseudonymously posted white paper[1] to more than 5000 privately-issued cryptoassets.[2] The original cryptoasset, Bitcoin, was launched on January 3, 2009, with a genesis transaction involving

1. The person or persons who used the pseudonym "Satoshi Nakamoto" wrote about the potential to create blockchains for digital assets using new consensus protocols in late 2008. *See* Satoshi Yakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN, bitcoin.org/bitcoin.pdf (last visited Sept. 2, 2021); Daniel Roberts, *Who Is Satoshi Nakamoto Inventor of Bitcoin? It Doesn't Matter*, FORTUNE (Dec. 9, 2015), https://fortune.com/2015/12/09/bitcoin-satoshi-identity/. This "white paper" originally appeared in an online discussion of cryptography.

2. Kate Ashford & John Schmidt, *What Is Cryptocurrency?*, FORBES: ADVISOR (Dec. 18, 2020), https://www.forbes.com/advisor/investing/what-is-cryptocurrency/. The rapid growth of crypto was a central thesis of a recent report on cryptoassets prepared for the European Parliament. Robby Houben & Alexander Snyers, Study for the Comm. on Econ. and Monetary Affs. on Crypto-assets, at 1 (2020), https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU(2020)648779_EN.pdf.

a reward of fifty Bitcoins that can never be spent.[3] The first reported transaction involving Bitcoins occurred on May 22, 2010, when 10,000 Bitcoins were used to buy two pizzas, marking a value of less than $.01 per Bitcoin.[4] CoinMarketCap.com began recording market prices for traded cryptoassets in 2013, with an all-time low trading price of $65.53 per Bitcoin recorded on July 5, 2013.[5] In late 2017, Bitcoin briefly peaked near $20,000 per coin before falling to under $4000 over the next two years.[6] Early in January of 2021, the trading price of Bitcoin reached new heights, exceeding $41,440 per coin before surging to over $60,000 per coin in April.[7]

Nor is Bitcoin the only cryptoasset of interest. As of January 8, 2021, the total market capitalization for all traded forms of crypto exceeded $1 trillion,[8] with a total market volume over the prior twenty-four hours exceeding $200 billion.[9] These developments place us squarely amid a rapidly developing and expanding technological

3. For a "deep dive" into the history of Bitcoin, see Jamie Redman, *A Deep Dive into Satoshi's 11-Year Old Bitcoin Genesis Block*, BITCOIN.COM (Jan. 3, 2020), https://perma.cc/83HN-U2PX.

4. This transaction reportedly occurred on May 22, 2010, when Laszlo Hanyecz agreed to pay 10,000 Bitcoins for two delivered Papa John's pizzas. Aaron Hankin, *Bitcoin Pizza Day: Celebrating the $80 Million Pizza Order*, INVESTOPEDIA, https://perma.cc/ZRH6-DMYT (last updated Jun. 25, 2019).

5. *See Historical Data for Bitcoin*, COINMARKETCAP, https://coinmarketcap.com/currencies/bitcoin/historical-data/ (last visited Jan. 5, 2022) (to find the all-time low price, click on the "Show More" box in the right-hand column at https://coinmarketcap.com/currencies/bitcoin/).

6. *Id.*

7. *Id.* You can select an appropriate date range to view April 2021 Bitcoin prices. To access the early January pricing referenced in the text, see *Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP (archived on Jan. 8, 2021, at https://perma.cc/63U6-JQGY).

8. *Today's Cryptocurrency Prices by Market Cap*, *supra* note 7.

9. *Id.* To access this information, click on "Read More," following the "Today's Cryptocurrency Prices by Market Cap" heading. It is also worth noting that by early April 2021, the total market capitalization of all cryptoassets had doubled to more than $2 trillion, with Bitcoin accounting for more than half of that amount. Gertrude Chavez-Dreyfuss, *Crypto Market Cap Surges to Record $2 Trillion, Bitcoin at $1.1 Trillion*, REUTERS (Apr. 5, 2021, 11:36 AM), https://perma.cc/RM56-8GUY.

revolution that some have called the Blockchain era,[10] and others have compared it to the internet.[11]

Notwithstanding the tremendous potential that this represents, there are still indications that in the minds of some, and particularly in the opinion of some U.S. regulators, crypto has never moved beyond its early association with criminals. As Marco Santori, a prominent fintech lawyer, once noted, the mindset of most regulators has long been that crypto is for criminals.[12] Some of the residual hostility is doubtlessly the lingering fallout from Silk Road[13] and other dark web marketplaces that proved Bitcoin could be used for criminal

10. *See, e.g.*, Yoav Vilner, *The Basics of Security Needs in the Blockchain Era*, FORBES (June 22, 2018, 2:13 AM), https://perma.cc/BCT7-MHY3.

11. Daniel Lanyon, *Blockchain Will Be "As Transformative as the Internet"*, ALTFI (Apr. 23, 2018), https://perma.cc/8ZW4-CWRR ("Almost nine in ten technology professionals believe blockchain technology will be as transformative for business as the internet has been for business over the past few decades . . . .").

12. Santori, then the head of Cooley LLP's New York blockchain tech team, reported in May 2017 about a meeting he attended in Washington, D.C.:

> FinCEN, IRS, FBI, DEA, SEC, CFPB, CFTC . . . just about any agency with a potential interest in magical internet money was there to hear us explain it to them. None were believers. In fact, the vibe in the room was clear: bitcoin is for criminals, and these apologists think they're going to change our minds.

Marco Santori, *Silk Road Goes Dark: Bitcoin Survives Its Biggest Market's Demise*, COINDESK (May 5, 2017), https://www.coindesk.com/markets/2017/05/05/silk-road-goes-dark-bitcoin-survives-its-biggest-markets-demise/.

13. Jake Frankenfield, *Silk Road (Website)*, INVESTOPEDIA (July 26, 2011), https://www.investopedia.com/terms/s/silk-road.asp (explaining the origin of Silk Road and its 2011 launch as part of the modern "dark web"). Founded by Ross Ulbricht, the site essentially operated as an "Amazon for drugs" (and other illegal objects and services). Robert Anthony, *The Craziest Things You Could've Bought on Silk Road, the Black Market of the Internet*, ELITE DAILY (Oct. 9, 2013), http://elitedaily.com/envision/the-craziest-things-you-couldve-bought-on-silk-road-the-black-market-of-the-internet/; *Silk Road: The Amazon.com of Illegal Drugs*, THE WEEK (Jan. 8, 2015) https://perma.cc/4UFT-VNL8. In October 2013, the FBI shut down the website and arrested Ross Ulbricht, who was eventually convicted of multiple crimes and sentenced to life imprisonment without the possibility of parole (a sentence that was upheld on appeal). *See* United States v. Ulbricht, 858 F.3d 71, 83, 131 (2d Cir. 2017), *abrogated by* United States v. Chambers, 751 F. App'x 44 (2d. Cir. 2018). Because all purchases on Silk Road had to be made in Bitcoin, this created an early and highly publicized connection between cryptoassets and criminal activities.

transactions.[14] That is far from the end of the story, however, as a recently released report from the Attorney General's Cyber Digital Task Force on Cryptocurrency clearly demonstrates.[15] The report has been described as "'a commercial reel of every financial crime known in crypto.'"[16]

The focus on criminal activity is perhaps not surprising given that it follows a 2018 report from the same Task Force, then under the leadership of Jeff Sessions, which recommended that the Department of Justice (DoJ) "'should continue evaluating the emerging threats posed by rapidly developing cryptocurrencies that malicious cyber actors often use.'"[17] Following that line of thought, it has been noted that the report cites "crime" and "criminals" 168 times.[18]

Although characterized by some in the crypto community as "negative spin,"[19] the reality is that there are bad actors who operate in the crypto ecosystem. As history demonstrates, where innovation outpaces regulatory response and there is money to be made, fraudsters and scam artists step in.[20] The crypto markets have proven to be no

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14. *See Ulbricht*, 858 F.3d at 85.

15. *See* U.S. DEP'T OF JUST., REPORT OF THE ATTORNEY GENERAL'S CYBER DIGITAL TASK FORCE: CRYPTOCURRENCY (2020) [hereinafter DOJ REPORT], https://perma.cc/F72X-8JY9.

16. Joshua Mapperson, *Community Reacts to New DoJ Crypto Enforcement Guidelines*, COINTELEGRAPH (Oct. 9, 2020) https://perma.cc/SB86-VAVC (quoting Coinshares's CSO Meltem Demirors).

17. DOJ REPORT, *supra* note 15, at vii (quoting U.S. DEP'T OF JUST., REPORT OF THE ATTORNEY GENERALS CYBER DIGITAL TASK FORCE 126 (2018)).

18. Mapperson, *supra* note 16.

19. *Id.* (quoting CryptoPennyCO2025 (@CryptoPennyCO), TWITTER (Oct. 8, 2020, 11:57 AM), https://twitter.com/CryptoPennyCO/status/1314248443678793728).

20. *See* Hugo van Driel, *Financial Fraud, Scandals, and Regulation: A Conceptual Framework and Literature Review*, 61 BUS. HIST. 1259, 1261 (2019), https://www.tandfonline.com/doi/pdf/10.1080/00076791.2018.1519026?needAccess=true ("([C]lustered) technological changes enlarge the opportunities for fraud by increasing uncertainty and information asymmetry, with the asymmetry making it harder both for investors and regulators to monitor fraud."). One particularly cogent criticism of the cycle of scandals and regulation is that "the habitual knee-jerk responses to scandals, mainly originating from law professors who lack business experience, have resulted in 'a pile of regulations with little rhyme and no reason.'" *Id.* (quoting JERRY W. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS: FROM ENRON TO REFORM 662 (2006)). *But cf.* Roberta Romano, *The*

exception to this phenomenon, unfortunately fostering the narrative that crypto is for criminals.[21] Some observers have claimed that even though the stereotyped connection between cryptoassets and criminal activity is oversimplified and tired, it has a basis in reality.[22]

The challenge for legitimate crypto entrepreneurs and enthusiasts is to thread the needle of existing regulations, and, where necessary, to change the narrative. In no place is the need for regulatory clarity in the U.S. greater than in the realm of securities regulation. One reason for the need for clarity and restraint is that the U.S. has sought to expand the reach of its laws far beyond the geographic boundaries of the nation. There are reasons why the U.S. Securities and Exchange Commission (SEC) and courts have done this, but the potential harm of overregulation should not be discounted.

Following this introduction, Part II of this Article will briefly review the SEC's approach to crypto including a consideration of the extent to which this approach has driven many offerings offshore. Part III focuses on *SEC v. Telegram*,[23] analyzing the facts of that case and explaining the judge's rulings, including his decision to enforce a preliminary injunction against the issuance of a planned cryptoasset that would have been called "Grams" on a worldwide basis.[24] Part IV involves a more detailed analysis of the global reach of the *Telegram* ruling, including a consideration of extraterritoriality in general, and the benefits and risks of such a broad application of U.S. law. The

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Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L.J. 1521, 1524 (2005) ("[S]hifts in national mood and turnover of elected officials, coupled with focusing events, . . . [are] key determinants that open 'policy windows' for policy entrepreneurs to link their proposed solutions to a problem."). One of the conclusions offered by van Driel was that the era of tighter regulation from 1945 to 1980 "saw relatively few big and widely publicised [sic] scandals" while the deregulation dating from the late 1970s "is now seen by many as responsible for the big scandals that surfaced in the following decades." van Driel, *supra* at 1273.

21. *See, e.g.*, Nathaniel Popper, *Bitcoin Has Lost Steam. But Criminals Still Love It*, N.Y. TIMES (Jan. 28. 2020), https://perma.cc/5WTF-MRF5.

22. Will Heasman, *Criminal Activity in Crypto: The Fact, the Fiction and the Context*, COINTELEGRAPH (Nov. 30, 2019), https://perma.cc/DS6X-SL6H.

23. SEC v. Telegram Grp. Inc., 448 F. Supp. 3d 353 (S.D.N.Y. 2020) [hereinafter Telegram Order].

24. SEC v. Telegram Grp. Inc, No. 19-cv-9439, 2020 WL 1547383, at *2 (S.D.N.Y. 2020) [hereinafter Telegram Update].

Article then concludes with suggestions for a reconsideration of this approach, especially in the context of crypto offerings.

II. A BRIEF HISTORY OF THE SEC'S APPROACH TO CRYPTO

The three-fold mission of the SEC is "to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[25] In furtherance of these objectives, the SEC has carefully watched developments relating to cryptoassets, resulting first in a number of public warnings advising potential purchasers to be very careful and wary of specific kinds of fraud.[26] The agency then took the position in 2017[27] that a transaction involving cryptoassets must be regulated under the securities laws if the sale in question involves an investment contract as defined by the so-called *Howey* Investment Contract Test.[28] Since that time, the list of enforcement actions initiated by the SEC against crypto entrepreneurs has continued to grow.[29]

25. *About the SEC*, U.S. SEC. & EXCH. COMM'N, https://perma.cc/TY77-3ZWX (last updated Nov. 22, 2016).

26. For example, in late 2017, SEC Chairman Jay Clayton warned about "concerns" with the crypto markets, noting the "greater opportunit[y] for fraud and manipulation." Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017), https://perma.cc/ZX3Y-SDN6. This statement also references several "investor alerts, bulletins, and statements on initial coin offerings and cryptocurrency-related investments, including with respect to the marketing of certain offerings and investments by celebrities and others." *Id.*

27. U.S. SEC. & EXCH. COMM'N, RELEASE NO. 81207, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO 11 (2017) [hereinafter DAO REPORT], https://perma.cc/F862-YS5V.

28. This test comes from *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946). In very general terms, as interpreted over time, the *Howey* test says that an asset is an investment contract and, therefore, is a security if it requires an investment in a common enterprise where the purchasers are hoping for profits based on the essential entrepreneurial efforts of others. *See* discussion *infra* Part II.A.

29. For a list of various SEC enforcement actions involving cryptoassets, see *Cyber Enforcement Actions*, U.S. SEC. & EXCH. COMM'N, https://perma.cc/6VE4-CZMA (last updated Dec. 28, 2020). One of the most significant actions, ongoing as of the date this was written, is against Ripple Labs and its initial and current CEOs. *See* Complaint, U.S. Sec. & Exch. Comm'n v. Ripple Labs, Inc., 20 Civ. 10832 (S.D.N.Y. Dec. 22, 2020), https://perma.cc/C3GK-ZXY5. This action targets the sale of 14.6 billion XRP tokens since 2013, which earned more than $1.38 billion USD. *Id.* at ¶ 1. ("$" means USD, unless otherwise noted.).

To understand the SEC's response to the growing worldwide interest in cryptoassets, a brief review of the *Howey* Investment Contract Test is essential, as there is no specific reference to anything resembling cryptoassets in the U.S. federal securities laws currently.

A. The Howe*y Investment Contract Test*

The Securities Act of 1933[30] contains a definition of security which includes terms with specific, well-understood meanings as well as words that are more elastic and possess less defined parameters.[31] For purposes of crypto, the most important category of "securities" is anything that qualifies as an "investment contract."[32]

The phrase "investment contract" is not defined in the statute but rather by case law. In 1946, the U.S. Supreme Court held in *SEC v. W.J. Howey*[33] that "an investment contract for purposes of the Securities Act means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ."[34] Now simply known as the *Howey* test, this approach has been clarified so that it is clear that investments other than money will be sufficient,[35]

30. This Act, often referred to as the Securities Act or '33 Act, is codified at 15 U.S.C. § 77a. It includes the requirement that it is illegal to sell or offer to sell any security unless it is registered or exempt from registration. *Id.* § 77e.

31. *See* 15 U.S.C. § 77a(1).

32. Another particularly important part of federal securities law is the Securities Exchange Act of 1934, which is codified at 15 U.S.C. § 78a, and often called the Exchange Act or simply the '34 Act. The '34 Act includes rules applicable to brokers and exchanges and has a definition which is similar, albeit not identical, to the definition that appears in the '33 Act. *Compare* 15 U.S.C. § 77a(1), *with* 15 U.S.C. § 78c(a)(10). Notwithstanding the differences in wording, the U.S. Supreme Court has indicated that the provisions in the two acts should be interpreted as meaning the same things, or in other words, *in pari materia*. *See* Tcherepnin v. Knight, 389 U.S. 332, 335–36 (1967).

33. SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

34. *Id*. at 298.

35. While the *Howey* test originally spoke only of "money," subsequent opinions have made it clear that "cash is not the only form of contribution or investment that will create an investment contract. Instead, the "'investment' may take the form of 'goods and services' or some other 'exchange of value.'" Uselton v. Com. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991) (citation omitted) (quoting Int'l Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of Am. v.

and minor investor participation will not prevent the last part of the test from being satisfied.[36] Thus, modern courts have generally characterized the *Howey* test as requiring the following elements: there is an investment of money (or something else of value);[37] in a common enterprise;[38] where the purchaser expects to receive profits;[39] and the

Daniel, 439 U.S. 551, 560 n.12 (1979) and Hocking v. Dubois, 885 F.2d 1449, 1471 (9th Cir. 1989)).

36. Although the Court in *Howey* said the expectation of profits needed to be based "solely" on the efforts of others, the rule has also been modified or clarified over time. *See* SEC v. Glenn W. Turner Enter., 474 F.2d 476, 481–82 (9th Cir. 1973) (finding that the appropriate inquiry is "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise"); *see also Hocking*, 885 F.2d at 1455 (holding that the test should be whose efforts are "significant" and "essential").

37. *See Howey*, 328 U.S. at 298–99.

38. *Id.* at 299. The requirement of a "common enterprise" is the element of the *Howey* test which appears to have received the most comment over the years, in part because there is a divergence among the federal circuits. Some courts appear to require "horizontal commonality," some accept "strict vertical commonality," while others accept "broad vertical commonality." *See* Maura K. Monaghan, Note, *An Uncommon State of Confusion: The Enterprise Element of Investment Contract Analysis*, 63 FORDHAM L. REV. 2135, 2152–63 (1995) (discussing the various judicial applications of the *Howey* "common enterprise" element). Horizontal commonality requires that investors' contributions be pooled together so their fortunes rise and fall together; strict commonality requires the investor and promoter or investment manager to have interests that are tied together; and broad commonality generally looks to whether the investor is depending heavily on the promoter in deciding whether to invest. *Id.*; *see also* Benjamin Akins, Jennifer L. Chapman, & Jason Gordon, *The Case for the Regulation of Bitcoin Mining as a Security*, 19 VA. J.L. & TECH. 669, 690 (2015).

On the other hand, while cases and academic commentators alike have relied on these elements for decades, officials at the SEC have taken issue with the "common enterprise" requirement. The Commission has explicitly suggested in recent documents that it "does not . . . view a 'common enterprise' as a distinct element of the term 'investment contract.'" U.S. SEC. & EXCH. COMM'N, FRAMEWORK FOR "INVESTMENT CONTRACT" ANALYSIS OF DIGITAL ASSETS 2 n.10 (2019) [hereinafter FRAMEWORK], https://perma.cc/J4KQ-HW52. Ironically, the text to which footnote 10 is appended and the note itself specifically recognizes that courts treat the *Howey* test as requiring a common enterprise as a distinct element.

39. *See Howey*, 328 U.S. at 299. The "expectation of profits" element has also been addressed numerous times. The U.S. Supreme Court held in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), that for this element to be met, "the primary motivation for investing must be to achieve a return on the value invested."

expectation of profits is from the essential entrepreneurial efforts of others.[40]

Since the SEC's 2017 report determining that tokens issued by The DAO fell within these guidelines,[41] the SEC has struggled to apply the pre-existing definitions and regulatory structure to cryptoassets in a consistent and coherent fashion. It has not always succeeded.

Early statements suggested that the SEC viewed all cryptoassets as securities, or at least presumed that they should be regulated as such.[42] The first significant deviation from this position involved

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Akins, Chapman, & Gordon, *supra* note 38, at 691 (citing *Forman*, 421 U.S. at 856–57).

40. *See supra* text accompanying note 36.

41. *See* DAO REPORT, *supra* note 27, at 11. The DAO launched in May 2016 with a very successful token distribution. It was meant to function like a venture capital fund for crypto-businesses, where persons who bought DAO Tokens could vote on funding for other crypto-businesses. Unfortunately, in June 2016, hackers exploited a weakness in the programming, which led to the failure of the enterprise shortly thereafter. About a year later, in July 2017, the SEC issued its report concluding that DAO Tokens were securities under the *Howey* test. Further, the SEC's report applied to the business called "The DAO." This does not cover all distributed autonomous organizations or "DAOs."

42. In September 2017, Co-Director of the SEC's Enforcement Division, Steven Peikin, analogized persons seeking quick profits from ICOs to cockroaches. Rachel Rose O'Leary, *'Roaches': SEC Chief Speaks Out Against Malicious ICOs*, COINDESK (Sept. 6, 2017), https://perma.cc/4T3L-FCW2. Beginning in December 2017, SEC Chairman Jay Clayton began repeating the mantra that most, if not all, ICOs involved the sale of securities. Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017), https://perma.cc/TY9T-MKWX ("By and large, the structures of initial coin offerings that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws."). In February 2018, in testimony before the Senate Committee on Banking, Housing, and Urban Affairs, he testified that "every ICO token the SEC has seen so far is considered a security . . . ." Joseph Young, *SEC Hints at Tighter Regulation for ICOs, Smart Policies for "True Cryptocurrencies"*, COINTELEGRAPH (Feb. 9, 2018), https://perma.cc/Z5KF-BXG9. While Chairman Clayton was always careful to explain that the SEC's approach required a consideration of the facts and circumstances of each transaction, his comments were widely accepted as reflecting at least a rebuttable presumption that all ICOs involved the sale of securities. *See, e.g.*, Daniel C. Zinman, James Q. Walker, Margaret Winterkorn Meyers, & Whitney O'Byrne, *SEC Issues Warning to Lawyers on ICOs*, BLOOMBERG L. (Feb. 22, 2018), https://perma.cc/FBB5-AWF9 (examining a few recent pronouncements and actions taken by the SEC and concluding that "the SEC has essentially adopted a rebuttable

statements to the effect that widely dispersed assets such as Bitcoin did not appear to fit the existing definition of investment contract because market forces drove pricing.[43] After deciding that Bitcoin and Ether were not securities, the SEC, through FinHub, an SEC portal designed to specifically engage with companies using blockchain and other innovative financial technologies, released a "Framework" designed to explain the SEC's approach in more detail.[44]

Rather than simplifying things, the Framework took the relatively short *Howey* test and expanded it into more than three dozen

presumption that ICO tokens are securities that must comply with the registration requirements of the securities laws"); Evelyn Cheng, *The SEC Just Made it Clearer That Securities Laws Apply to Most Cryptocurrencies and Exchanges Trading Them*, CNBC (Mar. 7, 2018, 6:48 PM), https://perma.cc/J7CY-CEZH.

43. In the summer of 2018, the SEC's Director of the Division of Corporate Finance, William Hinman, acknowledged that not all cryptoassets fit the definition of investment contract, specifically pointing to Bitcoin and Ether as examples of tokens which should not be viewed as securities. *See* William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, U.S. SEC. & EXCH. COMM'N (June 14, 2018), https://perma.cc/H3YU-DX3K. In the case of those two assets, Hinman suggested that the underlying network was "sufficiently decentralized" so that "purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts . . . ." *Id.* In his April 2018 testimony before the House Appropriations Committee, Chairman Clayton appeared to acquiesce in the view that Bitcoin, at least, would not be a security. He explained that "there are different types of cryptoassets . . . . A pure medium of exchange, the one that's most often cited, is Bitcoin. As a replacement for currency, . . . [Bitcoin] has been determined by most people to not be a security." Neeraj Agrawal, *SEC Chairman Clayton: Bitcoin is Not a Security*, COIN CENTER (Apr. 27, 2018), https://perma.cc/S8MF-7AKH.

44. On April 3, 2019, FinHub released a detailed "Framework" explaining how the SEC now plans to apply the *Howey* test to cryptoassets. *See* FRAMEWORK, *supra* note 38. In a joint staff statement, issued with the Office of General Counsel for FINRA, the SEC referred to covered cryptoassets as "digital asset securities." The Framework was accompanied by an explanatory statement from two SEC attorneys. *See* Bill Hinman & Valerie Szczepanik, *Statement on "Framework for 'Investment Contract' Analysis of Digital Assets*", U.S. SEC. & EXCH. COMM'N (Apr. 3, 2019), https://perma.cc/5CVA-RYFB. A joint statement between the SEC and FINRA followed explaining how digital assets, regardless of whether they are characterized as virtual currencies, coins, or tokens, may or may not be a security under the federal securities laws. *See Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities*, U.S. SEC. & EXCH. COMM'N (July 8, 2019) [hereinafter *Digital Asset Securities*], https://perma.cc/8A4T-J9H5.

different elements,[45] most of which focus on the question of whether purchasers would have a reasonable expectation of profits derived from the efforts of others.[46] While various characteristics are described as "especially relevant,"[47] the Framework notes that no single part of the test is "necessarily" determinative.[48] Perhaps even more confusing, the Framework suggests that interests may have to be reevaluated after the initial sale to determine whether an interest that is not originally a security might have become one.[49]

Regarding whether there is a reasonable expectation of profits, the Framework lists several characteristics and posits that the more that are present, the more likely the interest is to be a security.[50] The Framework does not, however, give any indication of how many of the described characteristics will be necessary or sufficient and does not indicate if any of the specified items will be weighted more heavily than the others.

Not surprisingly, this complicated formulation was not met with universal approval. Shortly after publication of the Framework, SEC Commissioner Hester Peirce gave a speech raising her concerns about the new explanation.[51] Her assessment of the Framework was less than glowing, noting that the document could "raise more questions and concerns than it answers."[52] As she observed:

> While *Howey* has four factors to consider, the framework lists 38 separate considerations, many of which include several sub-points. A seasoned securities lawyer might be able to infer which of these considerations will likely be controlling and might therefore be able to provide the appropriate weight to each . . . . [N]on-lawyers and lawyers not steeped in securities law and its attendant lore

45. As described *supra* at notes 37–40 and accompanying text, the *Howey* test is generally thought of as involving only four elements.

46. FRAMEWORK, *supra* note 38, at 2–11.

47. *Id.* at 3.

48. *Id.*

49. *Id.* at 5.

50. *Id.* at 6.

51. Hester M. Peirce, *How We Howey*, U.S. SEC. & EXCH. COMM'N (May 9, 2019), https://perma.cc/729A-CG6C.

52. *Id.*

> will not know what to make of the guidance. Pages worth of factors, many of which seemingly apply to all decentralized networks, might contribute to the feeling that navigating the securities laws in this area is perilous business.[53]

Notwithstanding criticisms such as this, on July 8, 2019, in a Joint Statement along with the Financial Industry Regulatory Authority (FINRA),[54] the SEC reiterated its commitment to the positions taken in the Framework. This Joint Statement more definitively articulated the position that some cryptoassets would not be securities, but the precise parameters of when such interests would be regulated as investment contracts were not laid out in the statement.

B. Pushing Crypto Development Away

The aggressive regulatory response from the SEC may have thwarted some fraudulent and criminal activities involving the sale of cryptoassets, but the Commission's expansive approach has been at a cost to legitimate entrepreneurs and potential investors. One of the most obvious costs is that many offerings have been structured to avoid the U.S. as much as possible, meaning that businesses lack access to funds and opportunities that might be available here and that interested potential American-based investors are out of luck.[55]

For example, it was reported that in the first quarter of 2019, eighty-six Initial Coin Offerings (ICOs) were specifically structured to exclude U.S.-based investors.[56] This made the U.S. the country most likely to be excluded from crypto offerings, "followed by North Korea, Iran, and Syria."[57]

53. *Id.* (emphasis omitted).

54. *Digital Asset Securities*, *supra* note 44. However, it should be noted that "[t]his statement is not a rule, regulation, guidance," or official pronouncement of the SEC and "has no legal force or effect." *Id.* at n.2.

55. In addition, of course, the decision to exclude the U.S. from such efforts puts the country behind in efforts to encourage economic development and technological progress in this area.

56. Lukas Hofer, *Why Token Issuers Exclude U.S. Investors*, ICO.LI (Apr. 26, 2019), https://perma.cc/JUB8-MCTF.

57. *Id.*

Of course, the securities laws are not the only reason why crypto-based businesses may be being pushed away from the U.S.,[58] but they certainly contribute to the problem. One commentator explained the situation as follows: "Over the past few years, most companies that created digital tokens and sold them through ICOs assumed they wouldn't be deemed securities. But when regulators think otherwise, startups can face major legal trouble . . . ."[59] Caitlan Long, a crypto proponent instrumental in moving Wyoming to the forefront of states supporting the new technology, has suggested that "[t]he SEC's stance has caused a massive flight of startups to offshore jurisdictions."[60] She also reports that lawyers tell clients, "[d]on't issue tokens to U.S. investors and don't domicile in the U.S."[61]

This is not what the SEC purports to want, especially given that its stated mission includes maintaining efficient markets and facilitating capital formation.[62] Unfortunately, despite repeatedly giving lip-service to the notion that the Commission does not want to stifle innovation,[63] it is unclear whether the SEC has followed through on those words.

Experts have warned that federal regulation should be designed with a "'light-touch'—providing the certainty and clarity that companies and investors need while not stifling innovation or burdening companies with restrictive requirements."[64] SEC Commissioner Hester

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58. *See, e.g.*, Nick Spanos, Opinion, *Why the US Cryptocurrency Revolution Could Be Pushed Overseas*, OBSERVER (Aug. 10, 2019, 10:00 AM), https://perma.cc/8YUD-WFEZ (pointing to burdens imposed by the U.S. tax laws).

59. Jeff Kauflin, *Crypto Startups Are Fleeing the U.S.—This Bill Is Trying to Stop Them*, FORBES (Jan. 10, 2019, 12:25 PM), https://perma.cc/4SLD-RMP2 (supporting Congressman Warren Davidson's Token Taxonomy Act to increase certainty regarding regulation and retain innovative enterprises in the U.S.).

60. *Id.*

61. *Id.*

62. *What We Do*, U.S. SEC. & EXCH. COMM'N, https://perma.cc/23XB-B27B (last updated June 10, 2013).

63. A list of positive statements from the SEC about supporting innovation and FinTech can be found at JD Alois, *Has the SEC Slammed the Brakes on Blockchain Innovation?*, CROWDFUND INSIDER (May 4, 2019, 4:15 PM), https://perma.cc/Z6LC-A8GT.

64. Timothy H. Lee, Opinion, *Regulations Need to Stabilize, Not Stifle, Cryptocurrency*, COLUMBUS DISPATCH (July 25, 2019, 4:15 AM),

Peirce has complained that the Commission's current approach is likely to be too heavy-handed and insufficiently clear. Dissenting from a settlement reached with Unikrn in September 2020,[65] Commissioner Peirce cautioned that the SEC needs to "strive to avoid enforcement actions and sanctions . . . that enervate innovation and stifle the economic growth that innovation brings."[66]

While heavy-handed enforcement is, in-and-of-itself, troubling, consider the ramifications when the SEC asks to employ its challenging interpretations of U.S. law outside the country's geographic boundaries. This is not a hypothetical scenario. In its ongoing push to address what it sees as the use of crypto to support illegal, criminal activities, the SEC has not only sought to apply its laws aggressively but has also sought an expansive application of its rules.[67] In this light, consider its recent action against Telegram Group Inc. and Ton Issuer Inc.,[68] jointly referred to as "Telegram" in the complaint,[69] most popular commentary,[70] and this Article.

https://perma.cc/ZD67-XSPC (discussing Representative Warren Davidson's Token Taxonomy Act proposal).

65. Unikrn, Inc., Securities Act Release No. 10841, 2020 WL 5542988 (Sept. 15, 2020).

66. Hester M. Peirce, *Statement on SEC Settlement Charging Token Issuer with Violation of Registration Provisions of the Securities Act of 1933*, U.S. SEC. & EXCH. COMM'N (Sept. 15, 2020), https://perma.cc/L4NN-G5S9.

67. Marc Powers, *Powers On . . . Broker Disintermediation and Unregulated Crypto Exchanges Cause Major Concerns*, COINTELEGRAPH (Aug. 24, 2021), https://perma.cc/Y3K5-JYHT (specifically noting the "expansive interpretation" of investment contract in the context of cryptoassets by the SEC and U.S. courts).

68. Complaint, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439, 2019 WL 5305462 (S.D.N.Y Oct. 11, 2019) [hereinafter Telegram Complaint].

69. *Id.*

70. *See generally*, David I. Miller & Charlie Berk, *SEC v. Telegram: A Groundbreaking Decision in Cryptocurrency Enforcement?*, 11 NAT'L L. REV. (Apr. 1, 2020), https://www.natlawreview.com/article/sec-v-telegram-groundbreaking-decision-cryptocurrency-enforcement#google_vignette; Anna Baydakova, *Making Sense of the SEC's Case Against Telegram*, COINDESK (Apr. 12, 2020, 9:00 AM) [hereinafter *Cooley Alert*], https://perma.cc/W553-4FH3; *SEC v. Telegram: Key Takeaways and Implications*, COOLEY (May 7, 2020), https://perma.cc/EXN5-Z9NG.

III. *SEC v. TELEGRAM*

Telegram is a popular global, cloud-based instant messaging, videotelephone and voice over service company with client apps available for Android, iPhone/iPad, PC/Mac/Linux, and macOS.[71] It originated in Russia although it has also had temporary headquarters in Berlin, London, and Singapore.[72] For some time the company did not readily disclose where it had offices, citing the desire to "shelter [the] team from any 'unnecessary influence'" and protect users' privacy.[73] However, as of this writing, a FAQ hosted on Telegram's homepage claims that the development team is based in Dubai.[74] Regardless of where the development team is based, Telegram has gained hundreds of millions of users worldwide.[75]

Telegram planned two distinct phases of fundraising, and in January 2018, it began raising capital.[76] In the initial phase, which lasted from January to March of 2018, Telegram sold contractual rights to acquire approximately 2.9 billion digital tokens (to be called Grams) to 171 initial purchasers worldwide in a Simple Agreement for Future

71. *See Telegram: A New Era of Messaging*, TELEGRAM [hereinafter *Telegram*], https://perma.cc/VM8K-5F3P (last visited Nov. 2, 2021).

72. *Russia's Zuckerberg Launches Telegram, A New Instant Messenger Service*, REUTERS (Aug. 29, 2013, 11:30 PM), https://www.reuters.com/article/idUS74722569420130830; *Telegram*, *supra* note 71.

73. John Thornhill, *Lunch with the FT: Pavel Durov*, FIN. TIMES (July 3, 2015), https://www.ft.com/content/21c5c7f2-20b1-11e5-ab0f-6bb9974f25d0.

74. *Telegram*, *supra* note 71. The Telegram complaint alleged that Telegram Group Inc. is a privately held British Virgin Islands company. Telegram Complaint at ¶ 16, No. 19 Civ. 9439, 2019 WL 5305462 (S.D.N.Y Oct. 11, 2019)

75. According to the SEC's complaint, at the time of its enforcement action, Telegram reportedly had approximately three hundred million monthly users. Telegram Complaint at ¶ 36, 2019 WL 5305462. Telegram estimated that it has more than this number of users. On April 24, 2020, it reported that it amassed four hundred million monthly users worldwide. *See* Manish Singh, *Telegram Hits 400M Monthly Active Users*, TECHCRUNCH (Apr. 24, 2020, 6:26 AM), https://perma.cc/AZ9Z-KHPY.

76. Telegram Complaint at ¶ 2, 2019 WL 5305462.

Tokens (SAFT).[77] These sales were limited to accredited investors.[78] Within this group, a total of thirty-nine U.S. investors purchased the right to acquire more than a billion Grams.[79] These sales were designed to be exempt from the U.S. securities registration requirements

77. The SAFT process was originally developed as a way for crypto entrepreneurs to comply with U.S. securities laws. A SAFT involves the two stages contemplated by Telegram: an initial sale of contractual rights followed by the launch of completed tokens at a later date. *See* Juan Batiz-Benet, Jesse Clayburgh, & Marco Santori, *The SAFT Project: Toward a Compliant Token Sale Framework*, COOLEY (Oct. 2, 2017) [hereinafter *SAFT White Paper*], https://perma.cc/XDP4-MQU5. The idea was that crypto developers should be able to sell contractual rights entitling purchasers to receive utility tokens which would not qualify as securities once they became fully functional.

In the first phase, the contractual rights, which were called SAFTs, were acknowledged to be a security. One commentator noted, the "SAFT is not a 'presale[;]' it is a sale of an investment contract which is itself a security." Andrew Stephenson, *SAFT; What is a SAFT and How Does it Work for Compliant ICOs/STO?*, MANHATTAN STREETCAPITAL (Dec. 4, 2017), https://perma.cc/4ZS3-RPVS. The SAFTs would be sold in an exempt offering—typically conducted in a sale to accredited investors designed to be exempt from registration under Rule 506(c) of Regulation D of the '33 Act. *SAFT White Paper*, *supra* note 77 at 16–17.

In the second phase, the fully functional tokens would be sold. The belief was that launching a functional token which was not sold as an investment in the enterprise would create "very strong arguments against characterization as a security: [s]uch tokens rarely satisfy both the 'expectation of profits' and 'from the efforts of others' prongs of the *Howey* test." *Id.* at 9. The document first contends that a profit motive does not predominate when a utility token is involved. The document then suggests that market appreciation cannot satisfy the "efforts of others" requirement of *Howey*. *Id.*

Technically speaking, Telegram did not utilize the SAFT documentation. In the face of resistance from the SEC, many other labels have been applied to these kinds of arrangements, and in Telegram's case, the label used was "Gram Purchase Agreement." Courtney Rogers Perrin, Frost Brown Todd LLC, *SAFTs May Survive Telegram's Garbled Message*, LEXOLOGY (Nov. 19, 2019), https://www.lexology.com/library/detail.aspx?g=080c73f9-b272-4178-8aed-a5ef078493e0. Despite the nomenclature, the Telegram offering relied on the SAFT process, with the initial sale of contractual rights designed to be followed by a later launch of the network and cryptoassets. This Article refers to the Telegram process as involving SAFTs.

78. Telegram Complaint at ¶ 2, 2019 WL 5305462.

79. *Id.*

pursuant to the terms of Rule 506(c) of Regulation D.[80] The proceeds of that offering were to be used, in part, to finance the development of the "Telegram Open Network," also known as the "TON Blockchain."[81]

In the second stage of its fundraising, Telegram planned on issuing the functional Grams.[82] SAFT holders would have their contractual rights converted, and members of the public would be allowed to purchase Grams upon the launch of the TON Blockchain, which was scheduled to occur no later than October 31, 2019.[83] Following the launch, both the initial SAFT investors and Telegram would be able to sell Grams to additional purchasers even though some of the initial purchasers had a vesting schedule which determined when they could sell their Grams.[84] Because the plan was to have a fully functional blockchain and tokens before this occurred, the position taken by Telegram was that at the time of the launch, the Grams would not be securities but instead would be a currency or commodity.[85]

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80. In the *Telegram* litigation, both parties stipulated that Telegram relied on 506(c) of Regulation D to exempt the sale of contractual rights. *See* Telegram Order, 448 F. Supp. 3d 353, 361 (S.D.N.Y. 2020) (referring to Joint Stip. ¶¶ 48, 52, & 55).

Regulation D offers three levels of exemption from the registration requirements of the federal securities laws. It appears at 17 C.F.R. §§ 230.501–.508. Rule 506(c) refers to § 506(c) of those provisions, which includes one of those exemptions. Rule 506(c) allows issuers to advertise a distribution and to raise unlimited amounts if sales are made exclusively to verified, accredited investors. Accredited investors are defined in 17 C.F.R. § 230.501(a) and generally include wealthy individuals, those with a close connection to the issuer of a given security, and various entities. For a more detailed explanation of who counts as an accredited investor, see *Accredited Investors—Updated Investor Bulletin*, INVESTOR.GOV (Apr. 14, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3.

81. *See* Telegram Complaint at ¶¶ 38, 55, 2019 WL 5305462 (noting that the defendants had stated in the offering documents that the funds "would be used for both Messenger and development of the TON Blockchain . . .").

82. *See* Telegram Order, 448 F. Supp. 3d at 361 (referring to Joint Stip. ¶¶ 55–56).

83. *Id.* at 363.

84. *See id.* at 372–73.

85. *See* Defendants' Answer, Defenses and Affirmative Defenses to Plaintiff's Complaint ¶ 3, SEC v. Telegram Group Inc., No. 19 Civ. 9439, 2020 WL 61528 (S.D.N.Y. Nov. 12, 2019) [hereinafter Telegram Answer], https://www.crowdfundinsider.com/wp-content/uploads/2019/11/SEC-v.-Telegram-NOV-19.pdf. A copy of

Very shortly before the Grams were to be delivered in the fall of 2019, the SEC filed an emergency action alleging that Telegram had violated the federal securities laws by conducting an unregistered digital token offering in the U.S. and overseas.[86] As part of its complaint, the Commission requested, and received, an ex parte TRO to prevent Telegram from "'flooding the U.S. markets with digital tokens that we allege were unlawfully sold.'"[87] Telegram responded promptly,[88] claiming that there was no need for an emergency order[89] and requesting the court deny the Commission's request for a preliminary injunction.

The company also sent a letter to investors explaining its disagreement with the SEC. Investors were informed that Telegram was actively working on a solution although the contract between Telegram and its investors included a force majeure clause protecting Telegram from liability as a result of delays caused by government intervention.

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the answer is embedded in Cali Haan, *Telegram Files Response to SEC Action Blocking U.S. Token Sales*, CROWDFUND INSIDER (Nov. 13, 2019, 2:07 PM), https://www.crowdfundinsider.com/2019/11/154062-telegram-files-response-to-sec-action-blocking-us-token-sales/ (the live page will have to be accessed for the answer to load).

86. Telegram Complaint at ¶¶ 9, 120–21, 2019 WL 5305462.

87. Press Release, U.S. Sec. & Exch. Comm'n, SEC Halts Alleged $1.7 Billion Unregistered Digital Token Offering (Oct. 11, 2019), https://perma.cc/759K-97DH.

88. Defendants' Response in Opposition to Plaintiff's Emergency Application for Preliminary Injunction, SEC v. Telegram Group, No. 19 Civ. 9439, 2020 WL 61528 (S.D.N.Y. Oct. 16, 2019) [hereinafter Telegram Response], https://s3.cointelegraph.com/storage/uploads/view/b0aeed1200364b1667279758a60b0a6a.pdf.

89. This initial response specifically alleged that Telegram had spent the preceding eighteen months in voluntary talks with and soliciting feedback from the SEC "consistent with the SEC's publicly stated desire to engage with developers of digital asset technologies." *Id.* at 1 (citing *Strategic Hub for Innovation and Financial Technology (FinHub)*, U.S. SEC. & EXCH. COMM'N (June 25, 2021), https://perma.cc/4WFH-6HKA). As of June 25, 2021, this page "encourages anyone working with RegTech solutions or implementations to engage with FinHub as part of this initiative." *See Strategic Hub for Innovation and Financial Technology*, *supra*. In addition, the Telegram response claimed that despite being fully aware of the terms of the proposed offering, "the SEC (i) never requested that Telegram delay the launch of the TON Blockchain; [and] (ii) never advised Telegram of its intention to seek injunctive relief . . . ." Telegram Response at 2, 2020 WL 61528.

Telegram announced a temporary halt to its work and the planned distribution.[90]

On November 12, 2019, Telegram filed an answer to the SEC's complaint denying the SEC's allegations and claiming that the SEC was engaging in "regulation by enforcement."[91] Two Amici Curiae briefs were submitted in support of Telegram's position, both taking the position that the Grams should not be presumed to be securities.[92] In opposition to those arguments, three experts for the SEC opined that the TON network was not sufficiently mature and decentralized to function without additional input from Telegram and that a reasonable investor would have purchased the tokens with an expectation of profit.[93] The Commodity Futures Trading Commission (CFTC) also filed a brief, stating that although its position was that the Grams were commodities, that conclusion should not preclude them from also being regulated as securities.[94]

90. Nikhilesh De, *Telegram Responds to SEC: Gram Tokens Are Not Securities*, COINDESK (Oct. 17, 2019, 10:55 AM), https://www.coindesk.com/telegram-responds-to-sec-gram-tokens-are-not-securities.

91. Telegram Answer at 1, No. 19 Civ. 9439, 2020 WL 61528 (S.D.N.Y. Nov. 12, 2019), https://www.crowdfundinsider.com/wp-content/uploads/2019/11/SEC-v.-Telegram-NOV-19.pdf.

92. Anna Baydakova, *Blockchain Association Sides with Telegram Against SEC, Says Grams Are Not Securities*, YAHOO!FINANCE (Jan. 22, 2020), https://finance.yahoo.com/news/blockchain-association-sides-telegram-against-121713959.html. A link to the Blockchain Association's amicus brief can be found at *Blockchain Association Stands Up for Crypto Industry in Amicus Brief for Telegram Case*, BLOCKCHAIN ASS'N, (Jan. 21, 2020), https://medium.com/@BlockchainAssoc/blockchain-association-stands-up-for-crypto-industry-in-amicus-brief-for-telegram-case-2a0d92a3803b. A copy of the amicus brief by the Chamber of Digital Commerce may be accessed at *Chamber of Digital Commerce Brief*, SCRIBD https://www.scribd.com/document/443720472/Chamber-of-Digital-Commerce-brief (last visited Nov. 3, 2021). Both the Digital Chamber of Commerce and the Blockchain Association are not-for-profit organizations seeking to promote blockchain-based technologies.

93. Stefan Stankovic, *SEC Taps 3 Experts on Why Telegram's Token is a Security*, CRYPTO BRIEFING (Jan. 30, 2020), https://perma.cc/B3GR-PY5N.

94. Shiraz Jagati, *CFTC Joins the* Telegram Vs. SEC *Case, Shedding Light on Likely Verdict*, COINTELEGRAPH (Feb. 21, 2020), https://perma.cc/K2YB-RGH4.

On February 19, 2020, the SEC and Telegram each presented arguments on the "economic realities" of the planned Grams.[95] The SEC argued that the entire plan of distribution should be treated as a single transaction.[96] Telegram responded that the SAFT sales and eventual launch of the Gram tokens should be viewed as two distinct events, with only the first involving the sale of investment contracts.[97] The judge initially extended the initial stipulated injunction, while indicating he would rule on the motion prior to April 30, the last date on which Telegram would be allowed to launch the TON network in compliance with the SAFT documentation.[98]

On March 24, 2020, the court granted the SEC's request for a preliminary injunction, halting the proposed sale of Grams:

> The Court finds that the SEC has shown a substantial likelihood of success in proving that the contracts and understandings at issue, including the sale of 2.9 billion Grams to 175 purchasers in exchange for $1.7 billion, are part of a larger scheme to distribute those Grams into a secondary public market, which would be supported by Telegram's ongoing efforts. Considering the economic realities under the *Howey* test, the Court finds that, in the context of that scheme, the resale of Grams into the secondary public market would be an integral part of the sale of securities without a required registration statement.[99]

Telegram appealed this ruling to the Second Circuit[100] and sought clarification from the trial court asking the judge to limit the scope of the order to U.S. purchasers. On April 1, 2020, Judge Castel,

95. David I. Miller & Charlie Berk, SEC v. Telegram*: A Groundbreaking Decision in Cryptocurrency Enforcement*?, GREENBERGTRAURIG (Apr. 1, 2020), https://perma.cc/65ME-5GUE.

96. *Id.*

97. *Id.*

98. Sead Fadilpašić, *Telegram's Battle to End by April 30, Judge Focuses on 'Economic Realities'*, CRYPTONEWS (Feb. 20, 2020, 4:59 AM), https://perma.cc/8ZRR-PAN7.

99. Telegram Order, 448 F. Supp. 3d 353, 358 (S.D.N.Y. 2020).

100. Richard B. Levin & Stephen A. Rutenberg, *Hanging on the Telephone: Judge Enters Order Blocking Telegram ICO Tuesday*, NAT'L L. REV. (Apr. 14, 2020), https://perma.cc/LS54-B94M.

after castigating Telegram for failing to raise the issue earlier, refused to limit his ruling on the basis that there was a substantial risk of resales to U.S. citizens, thereby making it clear that the injunction applied worldwide.[101]

In early May 2020, Telegram's Chief Executive Officer, Pavel Durov, announced that the company was dropping the TON blockchain project as a result of the district court's ruling.[102] Shortly thereafter, the company discontinued its appeal to the Second Circuit and agreed to return $1.2 billion to investors worldwide and to pay a fine of $18.5 million to the SEC.[103] Grams were never issued.

While the *SEC v. Telegram* order did not involve a final decision on the merits, and it was the opinion of a single district court judge,[104] the ramifications of the decision could nonetheless be profound. In addition to finding that the entire process likely involved an unregistered and therefore illegal distribution of securities,[105] the judge also prohibited the issuer, Telegram, from selling Grams anywhere in the

101. *See* Telegram Update, No. 19-cv-9439, 2020 WL 1547383, at *2 (S.D.N.Y. 2020).

102. *See* Kevin Helms, *Telegram Drops TON Cryptocurrency Project After U.S. Prohibits Global Distribution*, BITCOIN.COM (May 13, 2020), https://perma.cc/9K2N-VWTU.

103. Press Release, U.S. Sec. & Exch. Comm'n, Telegram to Return $1.2 Billion to Investors and Pay $18.5 Million Penalty to Settle SEC Charges (June 26, 2020), https://www.sec.gov/news/press-release/2020-146.

104. Judge Kevin Castel is a well-respected senior jurist in the Southern District of New York. Nominated to the U.S. District Court for the Southern District of New York in 2003 by President George W. Bush, Judge Castel was unanimously rated as well-qualified by the American Bar Association. *Kevin Castel*, BALLOTPEDIA, https://perma.cc/K6M7-X3TT (last visited Nov. 3, 2021). He assumed senior judge status in 2017. *Castel, P. Kevin*, FED. JUD. CTR., https://perma.cc/6FZY-FUW8 (last visited Nov. 3, 2021).

105. *See* Telegram Order, 448 F. Supp. 3d 353, 358 (S.D.N.Y. 2020) (concluding that the SEC had shown a "substantial likelihood of success in proving that the contracts and understandings at issue . . . are part of a larger scheme to distribute those Grams into a secondary public market . . . [which] would be an integral part of the sale of securities without a required registration statement"). In fact, section H of the Findings of Fact and Conclusions of Law in the Order is entitled "The Gram Purchase Agreements and Associated Understandings and Undertakings, Including the Expected Resales into the Secondary Market, Are Viewed as One Scheme Under *Howey*." *Id.* at 367.

world because of the risk of resales within the U.S.[106] It is the global reach of this ruling that creates the problem this Article focuses on.

IV. THE GLOBAL SCOPE OF U.S. ENFORCEMENT

Other materials have focused on *SEC v. Telegram*'s impact on the SAFT process.[107] Although that aspect of the decision is far from insignificant for U.S. crypto entrepreneurs, there is another aspect of the *Telegram* decision that is just as troubling, even though it is a result that is, at least, arguably supportable under current U.S. law. This problem stems from Judge Castel's unambiguous determination that the preliminary injunction should apply to sales of Grams that might occur anywhere in the world.

A. Judge Castel's Rationale

After the original preliminary injunction was entered in *SEC v. Telegram* by Judge Castel on March 24, 2020,[108] Telegram promptly responded by asking the court to clarify and limit its preliminary injunction so that the ruling would not prohibit sales outside the U.S. to persons other than U.S. citizens.[109] In its request, Telegram reminded the court that it was not a U.S. entity and that many of the contractual agreements which it had sold were entered into with purchasers who were physically located outside the U.S.[110] As such, these transactions would presumably already be governed by foreign law. Telegram therefore contended that "applying the injunction to cover sales to non-

106. Telegram Update, 2020 WL 1547383.

107. *See* Carol Goforth, SEC vs. Telegram*: Part 2 — The Case Against Integrating the Two Prongs of a SAFT*, COINTELEGRAPH (Sept. 22, 2020), https://perma.cc/DLH7-63ME; *see also* Carol Goforth, *Regulation of Crypto: Who is the SEC Protecting?*, 58 AM. BUS. L. J. (forthcoming 2021).

108. *See* Telegram Order, 448 F. Supp. 3d at 353.

109. *See* Telegram Update, 2020 WL 1547383, at *1 ("Telegram now asks the Court to 'clarify whether the scope of the preliminary injunction set forth in the [Opinion and] Order of [March 24, 2020] applies only to Purchase Agreements with U.S.-based investors.'").

110. Letter from Alexander C. Drylewski, Counsel for Telegram Grp. Inc., to J. P. Kevin Castel, S. Dist. of New York (Mar. 27, 2020), https://storage.courtlistener.com/recap/gov.uscourts.nysd.524448/gov.uscourts.nysd.524448.229.0.pdf.

U.S. Initial Purchasers would result in the extraterritorial application of U.S. securities laws."[111]

The court, in its relatively brief ruling denying the request, was very critical of Telegram.[112] First, the court berated the company for waiting until after the initial order to make its argument on the scope of the injunction.[113] The court then rejected the contention that the initial sale of contractual rights could be distinguished from the subsequent issuance of Grams:

> [F]ocusing upon the Initial Purchasers and their Gram Purchase Agreements misses one of the central points of the Court's Opinion and Order, specifically, that the "security" was neither the Gram Purchase Agreement nor the Gram but the entire scheme that comprised the Gram Purchase Agreements and the accompanying understandings and undertakings made by Telegram, including the expectation and intention that the Initial Purchasers would distribute Grams into a secondary public market. At the preliminary injunction stage, the intended resale of Grams by Telegram's conduits into the secondary market is likely to involve U.S. purchasers.[114]

Following this, the court went into some detail about the unfairness of Telegram waiting until this point in the process to propose ways in which redistribution of Grams into the hands of U.S. purchasers could be prevented.[115] Telegram suggested a range of safeguards

111. Robert A. Schwinger, *A 'Telegram' to SAFTs: 'Beware!'*, N.Y. L.J. (May 22, 2020, 12:30 PM), https://www.law.com/newyorklawjournal/2020/05/22/a-telegram-to-safts-beware/.

112. *See* Telegram Update, 2020 WL 1547383, at *2.

113. *Id.* at *1 (noting in the first paragraph of the order that the court used the "exact language of the preliminary injunction proposed by the SEC" five months earlier, and that the company "had a full and fair opportunity to explain why the relief sought by the SEC was overbroad"). Later in the opinion, the court repeats its observation that the post-order request was being raised "for the first time" late in the proceedings, *id.* at *2, and that "[t]he proposed form of the injunction has been known to Telegram since October 11, 2019." *Id.* at *2.

114. *Id.* at *2.

115. For example, Judge Castel complained that "Telegram's new proposals are raised long after the pre-injunction discovery period has closed and, as such, the SEC has been deprived of the opportunity to challenge their efficacy through expert

including "imposing express contractual prohibitions as a precondition to non-U.S. Private Placement purchasers receiving Grams,"[116] and "configuring the TON digital wallet to preclude U.S.-based addresses."[117] The court not only expressed its own reservations about the viability of these proposals but also noted that these "new proposals are raised long after the pre-injunction discovery period has closed, and, as such, the SEC has been deprived of the opportunity to challenge their efficacy through expert testimony or other evidence."[118]

Disregarding Telegram's European origin and United Arab Emirates operation, the ruling left Telegram with a worldwide injunction against selling Grams. As a starting point for analyzing the impact of this order, it is important to understand the legislative and regulatory framework underpinning the decision to apply U.S. law extraterritorially.

B. Extraterritoriality

While the SEC's mandate to protect U.S. markets and investors is broad, it is not without limitation. One significant restriction is that the focus of these laws should be on domestic enforcement. In fact, there is a long-standing presumption against the extraterritorial application of any federal law.[119] As explained elsewhere, under this view, "all legislation of Congress is presumed to apply domestically unless

testimony or other evidence." *Id.* at *2. In addition, the judge went out of his way to note that "[o]ne would expect a party opposing a preliminary injunction to include an argument in its very fulsome submissions that the grant of the requested injunction would be needless, overbroad, unworkable, apply extraterritorially, or any other argument it wished." *Id.* at *2.

116. *Id.* at *2.

117. *Id.* at *2.

118. *Id.*

119. Early decisions, which involved topics such as murder at sea and customs duties, focused on presumed Congressional intent to legislate only within Congress' "authority and jurisdiction." Apollon, 22 U.S. (9 Wheat.) 362, 370 (1824) (cited in Franklin A. Gevurtz, *Extraterritoriality and the Fourth Restatement of Foreign Relations Law: Opportunities Lost*, 55 WILLAMETTE L. REV. 449, 451 (2019)). By the beginning of the Twentieth Century, the Court focused on the broader proposition that courts should normally construe statutes to apply solely within national limits. Am. Banana Co. v. United Fruit Co., 213 U.S. 347, 357 (1909). According to Professor Gevurtz, this is the view that "eventually came to be known as the presumption against extraterritoriality." Gevurtz, *supra*, at 451.

Congress clearly manifests its intent for extraterritorial application."[120] The general rationale behind the presumption is predicated on two basic premises: (1) it is desirable to minimize unintended clashes between U.S. and foreign law which might result in international discord, and (2) Congress normally seeks to address domestic rather than foreign matters.[121]

Obviously, the presumption against extraterritorial application of U.S. law is subject to being rebutted. The clearest situation where extraterritorial application would be allowed is if the relevant legislation specifically includes rules regarding its international applicability. However, with regard to the federal securities laws which were the focus of the *Telegram* decision, both the Securities Act of 1933 and the Securities Exchange Act of 1934 are silent as to their extraterritorial reach.[122]

In 2010, Justice Scalia, writing for the majority in *Morrison v. National Australia Bank, Ltd.*,[123] held that § 10(b) of the Securities Exchange Act applies only to transactions in securities listed on domestic exchanges and domestic transactions in other securities.[124] The majority opinion explained the presumption against extraterritorial application of U.S. law as follows:

> It is a "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States . . . .'" [Thus,] "unless there is the affirmative intention of the Congress clearly expressed" to

120. Saisha Chandrasekaran, Recent Development, Liu Meng-Lin v. Siemens AG*: The Last of the Foreign Whistleblowers*, 23 TUL. J. INT'L & COMPAR. L. 557, 559 (2015) (footnotes omitted).

121. *Id.* at 559–60 (footnotes omitted).

122. Louis B. Kimmelman & Steven L. Smith, *Extraterritorial Application of United States Securities Laws*, *in* 3 BUSINESS & COMMERCIAL LITIGATION IN FEDERAL COURTS § 21:33 (4th ed. 2020) (footnotes omitted). Note that the 2010 Dodd-Frank Act includes language that "may" provide for extraterritorial application in some circumstances, although courts and commentators do not agree if this was the actual intent or effect of the 2010 legislation. *See infra* notes 124–31 and accompanying text.

123. 561 U.S. 247 (2010).

124. *Id.* at 273.

> give a statute extraterritorial effect, "we must presume it is primarily concerned with domestic conditions."[125]

In clarifying the reach of this observation, the Court explained that the mere presence of some domestic activity is not enough to justify applying U.S. law.[126] Instead, courts were directed to define the "objects of the statute's solicitude"[127] and then determine whether that "focus" would be within U.S. borders in the challenged activity.[128]

Very shortly after *Morrison* was decided, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).[129] Among many other provisions, Dodd-Frank amended the federal securities law to give federal courts "jurisdiction" over claims by the SEC or the United States involving "(1) conduct within the United States that constitutes significant steps in furtherance of [a] violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[130] Note that the amendment speaks only in terms of claims over which the federal courts have jurisdiction and does not specifically amend or broaden the authority of the SEC or the DoJ.

Because of this failure, the language of the rule has been criticized as being "hastily added,"[131] and for containing an apparent

125. *Id.* at 255 (citations omitted).

126. The actual language of the opinion is more colorful. "But the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever some domestic activity is involved in the case." *Id.* at 266.

127. *Id.* at 267.

128. *Id.* at 266 ("In *Aramco*, for example, the Title VII plaintiff had been hired in Houston, and was an American citizen. The Court concluded, however, that neither that territorial event nor that relationship was the 'focus' of congressional concern, but rather domestic employment.") (citation omitted).

129. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376.

130. *Id.* at § 929P(b), 124 Stat. at 1864. The SEC was directed to consider what rule should apply in private claims. *Id.* at § 929Y(a)(2), 124 Stat. at 1871. This mandate resulted in a report from the SEC in 2012. *See* U.S. SEC. & EXCH. COMM'N, STUDY ON THE CROSS-BORDER SCOPE OF THE PRIVATE RIGHT OF ACTION UNDER SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934 (2012), https://perma.cc/MZ4L-5LAM.

131. Gevurtz, *supra* note 119, at 468.

"drafting error."[132] The consequence of the rushed drafting has included substantial confusion among the lower federal courts as to what the provision really means. One commentator, in discussing the judicial reaction to the Dodd-Frank language, explained that since its enactment:

> [L]ower courts struggled without substantial guidance from the appellate courts as to the appropriate procedural and substantive standards to apply in cross-border securities cases involving enforcement actions. Lower courts have consequently hesitated to apply the standard from the congressional legislation and have instead adhered mostly to the Supreme Court holding in enforcement cases, though still acknowledging the possible impact of the congressional legislation.[133]

Some commentators have argued that the import of the Dodd-Frank language was not to overturn *Morrison* or expand the territorial reach of the SEC or DoJ, and instead was intended "merely" to define "the jurisdiction of federal courts to hear cases brought by those agencies and charges the SEC with the task of soliciting public comment as to the extraterritorial application of such laws in private rights of action."[134] Several experts have characterized this position as being "convincingly strong,"[135] although not everyone agrees with this assessment.

132. *See* Andrew Rocks, Note, *Whoops! The Imminent Reconciliation of U.S. Securities Laws with International Comity After* Morrison v. National Australia Bank *and the Drafting Error in the Dodd-Frank Act*, 56 VILL. L. REV. 163, 167 (2011).

133. Alina Veneziano, *How* SEC v. Scoville *Addresses the* Morrison-*Dodd-Frank Clash and Creates New Implications in Cross-Border Securities Transactions*, 47 SEC. REGUL. L.J. ART 2 (2019).

134. Rocks, *supra* note 132, at 166.

135. *See e.g.*, Meny Elgadeh, Note, Morrison v. National Australia Bank*: Life After Dodd-Frank*, 16 FORDHAM J. CORP. & FIN. L. 573, 593 (2011). Elgadeh goes on to state:

> A convincingly strong case could be made that Section 929P of Dodd-Frank has not effectively reversed the core holding of *Morrison*. The Dodd-Frank Act states in relevant part that "the district courts of the United States and the United States courts of any Territory shall have jurisdiction . . . alleging a violation . . . even if the

Professor Eric Chaffee, for example, applauded section 929P of Dodd-Frank as a "positive step" in that it "strengthens the SEC's role in regulating" global markets.[136] Even he, however, recognized that Congress' approach to establishing principles of extraterritoriality was "cautious."[137]

This has left the appropriate reach of federal securities laws outside the geographic boundaries of the U.S. open to debate. While the presumption against extraterritoriality continues to exist,[138] the proper application of federal securities law, as amended by Dodd-Frank and under the rules of *Morrison*, is far from clear. Under the language of *Morrison*, to allow extraterritorial application of the anti-fraud provisions of the federal securities laws, the court must ascertain the "objects of the statute's solicitude" and then determine whether the claimed violation is within that "focus."[139]

> securities transaction occurs outside the United States and involves only foreign investors . . . ."
>
> Significantly, the legislative text makes no mention of any change in the application of the securities laws. Rather it only speaks directly to a court's ability to hear a case, a power fully recognized by the majority in *Morrison*.

Id. at 593–94 (emphasis added).

136. Eric C. Chaffee, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: A Failed Vision for Increasing Consumer Protection and Heightening Corporate Responsibility in International Financial* Transactions60 AM. U. L. REV. 1431, 1446 (2011).

137. *Id.* at 1446–47.

138. For example, in 2013, the Supreme Court reaffirmed the presumption against extraterritoriality in the context of the Alien Tort Statute. Kiobel v. Royal Dutch Petroleum Co., 569 U.S. 108, 124 (2013). In *Kiobel,* Nigerian nationals living in the United States sued multiple foreign corporations in federal court under the Alien Tort Statute, and the Court concluded that neither the statutory language nor legislative history permitted extraterritorial application of the act. *Id.* The presumption against extraterritoriality has also been recently applied by the Court in *WesternGeco L.L.C., v. ION Geophysical Corp.*, 138 S. Ct. 2129, 2136 (2018) (patent infringement) and *RJR Nabisco v. European Community.*, 136 S. Ct. 2090, 2100 (2016) (private cause of action for RICO violations).

139. *See supra* notes 119–28 and accompanying text.

This focus approach is not limited to the narrow context of securities fraud under section 10b and rule 10b-5.[140] For example, in *RJR Nabisco v. European Community*,[141] the Court concluded that the statutory provision in question, which provided a private cause of action for persons injured by a violation of Racketeer Influenced and Corrupt Organizations Act (RICO), only applies if the injury occurs in the United States.[142] Two short years later, the Court found that the focus of the federal patent laws "allowing parties to recover damages from patent infringement is [where] the infringement [occurred] rather than [where] the damages" were incurred.[143] No convincing rationale was provided by the Court for flipping the test in this manner,[144] and there is no clear guidance on what this means in the context of the federal securities laws.

The inconsistency in rationale used to explain when it is appropriate to apply U.S. law to transactions occurring elsewhere means that Judge Castel's conclusion in *Telegram* is arguably correct under current law. While there is a presumption against extraterritorial reach of the U.S. laws, if the focus of the registration and exemption requirements is on the potential eventual injury, then there is a plausible argument that Congress intended the securities laws to apply. This would mean that Judge Castel was correct in finding that the U.S. securities laws apply broadly enough to cover the Grams distribution regardless of where Telegram itself is located and where the original purchasers are concentrated, particularly since Judge Castel viewed the entire plan as a single "scheme." This does not, however, end the discussion of whether this result is desirable or even justifiable in the overall view of things.

140. Section 10(b) of the '34 Act is codified at 15 U.S.C. § 78j(b), and rule 10b-5 is codified at 17 C.F.R. § 240.10b-5.

141. 136 S. Ct. 2090 (2016).

142. Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961–68. The section implicated in *RJR Nabisco* was 18 U.S.C. § 1964(c). *See RJR Nabisco*, 136 S. Ct. at 2106.

143. *See* Gevurtz, *supra* note 119, at 458; *WesternGeco*, 138 S. Ct. at 2138–39.

144. *See* Gevurtz, *supra* note 119, at 458.

C. The Benefits and Risks of a Wide Reach

As discussed above, "U.S. law [does] not apply to parties . . . [whose] 'transactions are definitively outside the United States.'"[145] As Judge Castel's ruling in *SEC v. Telegram* indicates, however, there is a wide range of situations in which courts might find a sufficient impact on U.S. citizens or markets to allow application of U.S. securities laws.[146] A very real question is whether they should.

From the perspective of U.S. regulators there are some obvious potential advantages to having the ability to directly influence events that "occur" outside of the country's national boundaries. First, more than at any other time in human history, we are living in a global world, where financial transactions routinely cross geographic boundaries.[147] Because the internet on which crypto is stored and transmitted is not and cannot be physically located within the confines of any single nation, cryptotransactions are inherently transnational.[148]

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145. *See* Alina Veneziano, Note, *Studying the Hegemony of the Extraterritoriality of U.S. Securities Laws: What It Means for Foreign Investors, Foreign Markets, and Efforts at Harmonization*, 17 GEO. J.L. & PUB. POL'Y 343, 351 (2019) (citing Wulf A. Kaal & Richard W. Painter, *Forum Competition and Choice of Law Competition in Securities Law After* Morrison v. National Australia Bank, 97 MINN. L. REV. 132, 135, 192 (2012)).

146. *See supra* Part IV.B.

147. The inter-connectedness of the world economy was quite apparent in 2008, when global financial markets were shaken by the collapse of the U.S. housing market. *See* Kevin McCoy, *2008 Financial Crisis: Could it Happen Again?*, USA TODAY (Sept. 9, 2013, 12:20 PM), www.usatoday.com/story/money/business/2013/09/08/legacy-2008-financial-crisis-lehman/2723733. The story quoted Senator Chris Dodd, who noted that, "'What happens in one corner of the world, particularly in significant economies, affects everybody.'" *Id.*

Regarding securities, the global nature of transactions is unassailable. As one noted commentator announced, "[g]lobal securities markets are a reality." Eric C. Chaffee, *A Call for Legislative Reform: Expanding the Extraterritorial Application of the Private Rights of Action Under Federal Securities Law While Limiting the Scope of Relief Available*, 22 STAN. J.L. BUS. & FIN. 1, 2 (2017); *see also* Douglas W. Arner, *Globalisation of Financial Markets: An International Passport for Securities Offerings?*, 35 INT'L LAW. 1543, 1585 (2001) (discussing "the move towards fully global offerings of securities"); Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 BROOK. J. CORP. FIN. & COM. L. 355, 356 (2007) (describing "the inevitable globalization of exchanges").

148. At their core, a cryptoasset is nothing but a string of numbers, having no tangible existence. This creates many interesting issues. For example, when it comes

The first advantage of having broadly applicable laws is that effective enforcement often requires international reach. One commentator explained this necessity as follows: "[T]he United States must maintain a system of securities regulation that makes sense in a world of global capital markets and global systemic risk."[149] In a world of global markets and transactions that cross national boundaries it is not possible to protect American interests if regulators can only oversee transactions that occur wholly within the geographic confines of the country.[150]

A related benefit of extraterritoriality is that companies cannot avoid the reach of U.S. law simply by moving their base of operations offshore.[151] The ability of crypto-entrepreneurs to circumvent U.S. law by basing their operations in foreign nations would create a perverse incentive for companies to locate their personnel and assets elsewhere while continuing to interact with U.S. customers. Avoiding U.S. law

time to pay taxes on gains, where should such gains be reported? The question, at least under U.K. law, has been framed as "how can you identify the location, or situs, of an intangible, digital asset, which is essentially a string of numbers and letters, recorded on a decentralised ledger known as the blockchain?" Natasha Oakshett & Lauren Rapeport, *The Situs of Cryptocurrencies: An Answer, But for How Long?*, WITHERSWORLDWIDE (May 20, 2020), https://www.withersworldwide.com/en-gb/insight/the-situs-of-cryptocurrencies-an-answer-but-for-how-long.

149. Chaffee, *supra* note 147, at 6. In Professor Chaffee's analysis of why extraterritorial application of the anti-fraud provisions of the securities laws is critical, he notes that it supports the underlying philosophy of full disclosure while dovetailing with the "'necessity for regulation' . . . because securities markets are interconnected and global in ways that they have not been in the past." *Id.* at 43.

150. It is, for example, often difficult to determine where some transactions occur. Kaal & Painter, *supra* note 145, at 193 (noting that "[t]he geographic location of a transaction, however, is in some instances difficult to identify" and in others easy to manipulate). Transactions in intangibles that can occur only through online markets, and are recorded in a decentralized distributed network, have no physical presence to ascertain.

151. For an article discussing this in the context of the need for extraterritorial application of whistleblower protections under Dodd-Frank, see Jasmine Gandhi, Note, *Protect Our Friends: The Extraterritorial Application of the Anti-Retaliation Provision of the SEC's Whistleblower Program*, 9 GEO. MASON J. INT'L COM. L. 100 (2017). This article argues that without extraterritoriality, to avoid U.S. law, companies are "incentivized to leave the American market or create subsidiaries in other countries. This offshoring practice can be detrimental to the American economy because many companies would be leaving the market and taking all the potential jobs overseas." *Id.* at 110–11.

is not quite so easy, although many crypto-businesses have sought to avoid U.S. regulators by locating their physical assets elsewhere and directing their offerings solely to individuals physically located outside the U.S., thereby placing their business elsewhere while affirmatively seeking to exclude U.S. citizens and residents from any opportunities they might create.[152] If U.S. regulators reached all of these offerings, then there would be no reason for such entrepreneurs to try and operate only elsewhere.

Some other potential benefits have also been claimed, although not everyone agrees that these are legitimate. Such benefits include the possibility that applying American law globally will result in convergence of legal requirements, with more nations adopting laws that actively seek to protect investors and markets.[153] This approach has the

152. *See, e.g.*, Benjamin Pirus, *Crypto Exchanges Barring US Citizens Is Heartbreaking And Frustrating*, FORBES (Sept. 30, 2020, 8:03 AM) https://perma.cc/A9UW-G6MG (complaining that "[a]rguably all the top crypto exchanges ban U.S. citizens," and suggesting that "[s]omething has to change"). SEC Commissioner Hester Peirce commented on this phenomenon:

> Other projects have sought to sever any ties with the United States to avoid the reach of our securities laws. This approach is risky because invariably some activity occurs in the United States. Moreover, this approach is detrimental to the U.S. economy because it prevents American citizens from participating in budding token networks. It is evident that any route chosen by a team to distribute tokens into the hands of potential users is fraught with uncertainty under the securities laws.

Hester M. Peirce, *Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization*, U.S. SEC. & EXCH. COMM'N (Feb. 6, 2020) [hereinafter *Running on Empty*], https://perma.cc/NC7N-4Z4T.

153. This argument is advanced by Chaffee, *supra* note 147, at 5.

potential to advance the goals of American influence and primacy,[154] while ideally promoting consistency of international requirements.[155]

From an outside perspective, the aggressive extension of U.S. securities laws into the inherently global crypto markets is problematic on several fronts. One of the most obvious problems is that it creates a significant risk of redundancy and over-regulation.[156] When U.S. requirements are imposed on transactions that occur elsewhere, with primary effects that are felt in other nations, the issuer could "already [be] complying with some other country's regulatory regime. These U.S. approaches would accordingly produce undesirable results such as redundant and unnecessarily costly systems of overlapping regulation and would thereby impede the free flow of capital across borders."[157]

A similar problem is that imposition of U.S. law into essentially foreign transactions is likely to inject both inconsistency and

154. Not everyone acknowledges that American primacy is a morally legitimate objective:

> The presumption against extraterritoriality is important and should be maintained. It prevents the United States from ruling on other countries' cases for other countries' nationals and strikes the proper balance between judicial efficiency and international comity. Courts must afford a degree of deference to the particular securities laws of other nations and consider broader factors such as "economic policy, procedural rules accompanying those regulations, and the spirit of that state's civil litigation system."

Alina Veneziano, *A New Era in the Application of U.S. Securities Law Abroad: Valuing the Presumption Against Extraterritoriality and Managing the Future with the Sustainable-Domestic-Integrity Standard*, 23 ANN. SURV. INT'L & COMPAR. L. 79, 112–13 (2018) (footnotes omitted).

155. Obviously, this latter objective would be realized only if other nations give-in to the notion that U.S. law is in their best interests or should control for other reasons.

156. Veneziano, *supra* note 145, at 360 ("Extraterritorial application is nothing more than global over-regulation. It involves the imposition of U.S. economic, political, and social regulation on foreign investors and foreign securities markets.").

157. Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 FORDHAM J. CORP. & FIN. L. 89, 102 (2003); *see also* Hannah L. Buxbaum, *Conflict of Economic Laws: From Sovereignty to Substance*, 42 VA. J. INT'L L. 931, 940 (2002); Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 555–56 (1993) (arguing that efficient securities regulation requires nations to limit the imposition of their laws outside their borders).

uncertainty into those transactions. Clearly, U.S. regulators do not have the resources to police every international transaction that might impact U.S. citizens or markets.[158] Even if the regulators make the effort, it is not at all clear when or whether U.S. courts will decide to apply our laws extraterritorially.[159] These facts alone introduce a considerable degree of uncertainty. Additional uncertainty is created as to how U.S. law might interact with local laws, which will inevitably differ from U.S. requirements.[160]

Another major risk associated with attempting to apply U.S. law to foreign transactions is increased international resentment. This is a pattern that has been observed before. For example, foreign governments have repeatedly disapproved of U.S. efforts to enforce anti-fraud mandates in other markets.[161] The reaction from foreign nations is generally that such efforts are "very intrusive"[162] and "arrogant."[163] Not

158. Luis A. Aguilar, *Statement by Commissioner: Defrauded Investors Deserve Their Day in Court*, U.S. SEC. & EXCH. COMM'N (Apr. 11, 2012), https://perma.cc/UH65-6CPC ("The truth of the matter is that the SEC, does not, and will not, ever have enough resources to investigate all of the fraud cases that exist. The SEC will never be able to seek justice in all of the potential transnational securities fraud matters."). Commissioner Aguilar's response to this concern was to advocate for broader private rights of action under U.S. law.

159. Louise Corso, Note, *Section 10(b) and Transnational Securities Fraud: A Legislative Proposal to Establish a Standard for Extraterritorial Subject Matter Jurisdiction*, 23 GEO. WASH. J. INT'L L. & ECON. 573, 601 (1989) (observing that the extraterritorial application of U.S. laws appears to be based predominately on the predisposition of individual judges).

160. Others have also commented on the challenges and uncertainty caused by trying to comply with U.S. and foreign laws. As Professor Jill Fisch once noted, "it is difficult, if not impossible, to comply simultaneously with U.S. law and the requirements of many foreign countries." Fisch, *supra* note 157, at 534.

161. Rocks, *supra* note 132, at 163–64 (citing Fisch, *supra* note 157, at 523–24) (characterizing the U.S. approach as "costly" since it "has offended the sovereignty of other countries which have reacted by passing retaliatory legislation of their own").

162. Scott M. Himes, *The Supreme Court Limits Transnational Securities Fraud Cases*, 79 U.S. L. WK. 1090, 1096 (July 7, 2010) (claiming that extraterritorial application of securities fraud laws is "deemed very intrusive abroad" because foreign actors can be subjected to "more costly and onerous procedures than judicial proceedings in their own countries . . . .").

163. John D. Kelly, Note, *Let There Be Fraud (Abroad): A Proposal for a New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts*, 28 LAW & POL'Y INT'L BUS. 477, 477 (1997) ("[N]ation-states have balked at the 'arrogance' with which U.S. courts

surprisingly, this creates the impetus for pushback where other nations seek to impose their laws and vision on U.S. businesses.[164]

Just as the U.S. has its own objectives and interests to protect, so too do other nations. Their approach to regulation of securities transactions and markets thus reflects their own unique priorities and needs, while blanket application of U.S. law "has continually overlooked these legitimate policy concerns in its attempts to regulate predominantly foreign conduct under domestic law."[165]

A system of international regulation where individual nations vie to have their particular viewpoint applied globally is antithetical to the goal of harmonization. Extraterritorial application of U.S. domestic law diminishes the role of traditional international law,[166] resulting not only in "'confusion, legal uncertainty, and difficulties'" but also a decreased impetus for cooperation by and between nations.[167] This is particularly problematic in the context of cryptoassets since instead of adopting new regulations to deal with the new technology, the U.S.

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have exercised jurisdiction over behavior that they consider to be solely within their sovereign domains.").

164. Austen Parrish, *The Interplay Between Extraterritoriality, Sovereignty, and the Foundations of International Law*, *in* STANDARDS AND SOVEREIGNS: LEGAL HISTORIES OF EXTRATERRITORIALITY 11 (Working Paper, Mar. 24, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2940361) ("Increasingly other nations have begun to act unilaterally—mimicking in their own ways the exceptionalism the U.S. promoted.").

165. *See, e.g.*, Rocks, *supra* note 132, at 164 (citing Gregory K. Matson, Note & Comment, *Restricting the Jurisdiction of American Courts over Transnational Securities Fraud*, 79 GEO. L.J. 141 (1990)).

166. Traditional principles of international law "present[] a clear norm of not applying law ex-traterritorially outside certain circumstances. This norm should still stand even when the conduct in question might be 'territorial' . . . , but which is still predominantly taking place in a country other than the United States." Samuel L. Hatcher, Note, *Circuit Board Jurisdiction: Electronic Payments and the Presumption Against Extraterritoriality*, 48 GA. J. INT'L & COMPAR. L. 591, 601 (2020); *see also* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 403(1) (AM. L. INST. 1987) ("[A] state may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable."). U.S. courts appear to be appropriately restrained under these principles when dealing with claims by private parties, but are far less so when dealing with agencies of the U.S. The SEC, for example, has opined that the mere routing of transactions through the U.S. is sufficient to subject participants to U.S. laws. Hatcher, *supra*, at 598.

167. Veneziano, *supra* note 145, at 354.

approach has "pursued regulation through enforcement litigation. Actors in the cryptocurrency economy have so far been subject to rigorous enforcement of registration, disclosure, and anti-fraud rules handed down by an assortment of regulatory agencies that rely on the creative use of decades-old legal authorities."[168] This does not align well with the approach taken in many other jurisdictions.[169]

The fact that U.S. priorities will never align perfectly with the needs and interests of other nations also means that other countries will face a host of social, political, and economic consequences when our law is forced upon transactions that are centered there. Other governments will have made different choices as to how to balance their need to maintain market competitiveness and to foster innovation while still appropriately regulating problematic behaviors. Imposing U.S. law across the board does not respect those priorities.[170]

The U.S. Supreme Court cautioned against the unrestrained extraterritorial application of U.S. law in 2010, noting in *Morrison v. National Australia Bank Ltd.*,[171] that absent clear guidance from Congress statutes should be construed "'to avoid unreasonable interference with the sovereign authority of other nations.'"[172] The Court explicitly recognized that "foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction. And the regulation of other countries often differs from ours . . . ."[173]

168. David H. McGill, Benjamin J.A. Sauter, & Beau D. Barnes, *Cryptocurrency Is Borderless—but Still Within the Grip of U.S. Regulators*, 31 INT'L L. PRACTICUM 11, 11 (2018).

169. For a consideration of many of the different approaches to regulation of cryptoassets around the globe, see LIBR. OF CONG., REGULATORY APPROACHES TO CRYPTOASSETS IN SELECTED JURISDICTIONS (Apr. 2019), https://perma.cc/SBK5-DGHB (summarizing the laws of more than forty nations in more than 250 pages).

170. Veneziano, *supra* note 145, at 355–56.

171. 561 U.S. 247 (2010).

172. *Id.* at 280 (Stevens, J., concurring) (quoting F. Hoffmann–La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 164 (2004)).

173. *Morrison*, 561 U.S. at 269. In support of adopting a narrow test for when extraterritorial application of U.S. securities laws would apply, the Court cited amicus briefs submitted by "Great Britain and Northern Ireland, . . . the Republic of France, . . . the International Chamber of Commerce, the Swiss Bankers Association, the Federation of German Industries, the French Business Confederation, the Institute of

Unfortunately, the SEC seems content with its current trajectory, meaning that unless there is a change in ideology at the Commission, or more consistent direction from the courts away from extraterritorial application of the U.S. securities laws, it will take legislative intervention to ensure a less aggressive response than we have seen to date.

D. Potential for Reconsideration

At this point, the question is where should legislators, courts, regulators, and entrepreneurs go from here. This Article takes the position that one of the most problematic aspects of the *SEC v. Telegram* ruling is the global reach of the injunction.[174] As such, either the SEC, other courts, or Congress should intervene to change the direction of current international enforcement efforts. Pending such a change, entrepreneurs should react cautiously, taking steps to distinguish any future crypto deals from the process that was relied upon by the issuer in *Telegram*.

With regard to the first of these alternatives, one might ask whether there is any realistic chance that the SEC will decide to change its approach. Given the lack of unanimity among current commissioners, it is not outside the realm of possibility for the Commission to decide to limit its past tendency to regulate through enforcement.[175] A number of commentators have suggested several ways in which the SEC might modify its approach to crypto regulation.[176] SEC

International Bankers, the European Banking Federation, the Australian Bankers' Association, and the Association Francaise des Entreprises Privées." *Id.*

174. The extraterritorial application of U.S. securities laws in *Telegram* is discussed *supra* at Part IV.A.

175. *See, e.g.*, Hester M. Peirce, *Not Braking and Breaking*, U.S. SEC. & EXCH. COMM'N (July 21, 2020) [hereinafter *Not Braking and Breaking*], https://perma.cc/2LDS-BTQL (objecting to the results in *U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc.*, 492 F. Supp. 3d 169 (S.D.N.Y. 2020).

176. For example, some commentators call for the SEC to use a more narrowly-tailored approach to applying the securities laws to cryptoassets. *See* Allen Kogan, Comment, *Not All Virtual Currencies Are Created Equal: Regulatory Guidance in the Aftermath of* CFTC v. McDonnell, 8 AM. U. BUS. L. REV. 199, 242 (2019). Some would like to see the SEC explicitly decide to exclude "utility tokens" from the reach of the federal securities laws. *See, e.g.*, Nate Crosser, Comment, *Initial Coin Offerings*

Commissioner Peirce, for example, has called for a three-year safe harbor for crypto sales.[177] History also suggests that the SEC is willing to at least modify its position in this rapidly changing area, moving from a paradigm in which "every ICO"[178] involves the sale of a security to explicitly recognizing that some cryptoassets should not be regulated as securities.[179]

In addition, there has been a change in administration and a change in the ranks of the appointed commissioners.[180] New commissioners could mean new ideas. The first replacement was for Chairman Clayton, who resigned on December 23, 2020, creating the first opening on the Commission.[181] This gave President Biden the opportunity to begin refocusing the agency, and on April 17, 2021, Gary Gensler was sworn in as the thirty-third Chairman of the SEC.[182] Chairman Gensler has, however, already indicated that he is in favor of regulating cryptoassets and is generally in agreement with the positions taken by his predecessor in this regard.[183]

The ability of President Biden to radically shift the SEC is limited by the rule that no more than half of the commissioners can come from a single political party,[184] and with the addition of Chairman Gensler there are already three Democrats serving.[185] Whether this will

as Investment Contracts: Are Blockchain Utility Tokens Securities?, 67 U. KAN. L. REV. 379, 384 (2018).

177. *Running on Empty*, *supra* note 152.

178. *See supra* text accompanying note 42.

179. *See supra* text accompanying note 43.

180. The President of the U.S. appoints the five commissioners for staggered terms, each scheduled to end on June 5. *See Current SEC Commissioners*, U.S. SEC. & EXCH. COMM'N, https://perma.cc/3ZR2-4K26 (last updated Dec. 29, 2020).

181. Jay Clayton, *Statement of SEC Chairman Jay Clayton Regarding the Conclusion of His Tenure*, U.S. SEC. & EXCH. COMM'N (Dec. 23, 2020), https://perma.cc/446V-E8TX.

182. *Chair Gary Gensler's Swearing-In*, U.S. SEC. & EXCH. COMM'N (Apr. 21, 2021), https://www.sec.gov/news/sec-videos/chair-gary-genslers-swearing-0.

183. Gary Gensler, *Remarks Before the Aspen Security Forum*, U.S. SEC. & EXCH. COMM'N (Aug. 3, 2021), https://perma.cc/L2FJ-6XLD.

184. *Current SEC Commissioners*, *supra* note 180.

185. As of August 2021, the Democratic commissioners include Chairman Gary Gensler, Allison Herren Lee, and Caroline Crenshaw. The two Republicans are Hester Peirce and Elad Roisman. Both Republican Commissioners have staked out positions that are generally more crypto-friendly than those taken by their Democratic

result in any significant changes in the SEC's overall approach to crypto regulation is yet to be seen, although it is quite likely that the Commission will continue to view crypto with suspicion.[186] Since conventional wisdom suggests that Democrats are likely to push for heavier not lighter regulation,[187] the change in Presidential leadership from

colleagues. For example, when the SEC settled charges against Coinschedule for improperly promoting certain cryptoassets, both Peirce and Roisman criticized the Commission for failing to offer regulatory clarity. *See* Cheyenne Ligon, *SEC Settles Charges Against Coinschedule Operator for Touting ICOs*, COINDESK, https://perma.cc/SJ8F-FS3K (last updated July 15, 2021, 4:13 PM).

186. From the outset of his time with the SEC, Chairman Clayton tended to regard all crypto suspiciously, treating all forms of cryptoassets as securities and worrying that all ICOs were being conducted illegally. *See* Clayton, *supra* note 26 (describing Clayton's early concerns about fraud and illegality); *see also* O'Leary, *supra* note 42 (suggesting that all crypto should be regulated as securities). Even after the SEC acknowledged that Bitcoin was not a security, Chairman Clayton had reservations about investments in it. Explaining the Chairman's views, one commentator writes "Clayton was never a staunch opponent of Bitcoin in principle but regularly expressed his fears that average investors could be subjected to unnecessary risk . . . ." Cyrus McNally, *Outgoing SEC Chair Jay Clayton Reveals What's Driving the Rise of BTC*, COINTELEGRAPH (Nov. 20, 2020), https://perma.cc/SC9K-29KL (discussing the possibility of a Bitcoin ETF). On the other hand, while Clayton was Chairman, the SEC initiated fifty-six cases against crypto businesses. *See* Helen Partz, *SEC Brought 56 Cases Against Crypto-Related Firms During Jay Clayton's Tenure*, COINTELEGRAPH (Nov. 17, 2020), https://perma.cc/RH63-PNJR. At least one commentator, in discussing what the change in administration might portend for the SEC's enforcement priorities, specifically commented on the anti-crypto enforcement emphasis under Chairman Clayton's leadership. "Clayton's tenure saw a special emphasis in two areas: matters affecting retail investors and cases involving fraud and registration violations in connection with initial coin offerings." Steven Peikin, *How Dems Could Alter SEC's Enforcement Approach*, LAW360 (Jan. 6, 2021, 4:26 PM), https://www.law360.com/articles/1341621/how-dems-could-alter-sec-s-enforcement-approach?nl_pk=90e22563-0a32-414c-8b90-a040fc4efeeb&utm_source=newsletter&utm_medium=email&utm_campaign=special (subscription may be needed to access story).

187. *See, e.g.*, Paul Kiernan & Dave Michaels, *SEC Chairman Jay Clayton to Leave Agency at End of 2020*, WALL ST. J., https://perma.cc/DNN3-SXWG (last updated Nov. 16, 2020, 8:10 PM) (noting that Chairman Clayton's departure "opens [the] door for Democrats to seek a tougher approach to regulation of Wall Street"). However, it is also worth noting the most of the 1500 staff members in the Enforcement division are mature professionals, with an average tenure of approximately fifteen years, meaning that extensive turnover or dramatic changes in priorities are unlikely. Peikin, *supra* note 186.

Trump to Biden is not necessarily a favorable development for crypto enthusiasts.

Given this complicated situation, a notable change in direction with regard to crypto enforcement by the SEC is a less than probable outcome, but it is not outside the realm of possibility. If the SEC does modify its approach to crypto offerings, we could see different results in future enforcement proceedings.[188]

A second alternative would be that future courts could elect to take a less aggressive approach regarding the extraterritorial application of U.S. securities laws as they relate to cryptoassets and transactions. For example, in *SEC v. Kik*,[189] the court agreed with Judge Castel that the *Howey* investment contract test should be employed to determine whether cryptoassets are securities.[190] Albeit for somewhat different reasons, Judge Hellerstein also agreed that the two phases of Kik's crypto offering—that original SAFT sales and the later sales of Kin tokens—should be treated as a single offering.[191] However, the final judgment in *Kik*, which was entered pursuant to an agreed-upon settlement, stopped far short of ordering a return of proceeds, a

188. The possibility that the SEC might change its position has been mentioned by others:

> [M]aybe the SEC will adopt some form of the three-year safe haven that Commissioner Peirce proposed . . . allowing new cryptocurrencies some time to become decentralized and widely circulated. Otherwise, as Telegram's amici warned, blockchain developers are going to have to think twice before looking to the U.S. for capital.

Alison Frankel, *SEC Wins Injunction Against Telegram Blockchain Launch in Key ICO Case*, REUTERS (Mar. 25, 2020, 6:04 PM), https://www.reuters.com/article/legal-us-otc-telegram/sec-wins-injunction-against-telegram-blockchain-launch-in-key-ico-case-idUSKBN21C3N0. Other possibilities could include a decision to focus more of its efforts on fraud, adopt something akin to a utility token test or a Ripple test which could exclude some kinds of crypto from registration requirements, or even limit actions to transactions more centrally located within the U.S. For a further explanation of what a Ripple test might look like, see Carol Goforth, *It is Time for the U.S. to Create a 'Ripple Test' for Crypto*, COINTELEGRAPH (July 21, 2021), https://perma.cc/XZ9X-WWDG.

189. U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc., 492 F. Supp. 3d 169 (S.D.N.Y. 2020).

190. Opinion and Order on Motions for Summary Judgment at 8–14, U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc., No. 19 Civ. 5244 (S.D.N.Y. Sept. 30, 2020), https://perma.cc/43WJ-K7JA [hereinafter Kik Order].

191. *Id.* at 14–17.

registration requirement, or a limit on future sales—other than a notice to the SEC requirement.[192] Because the *Kik* settlement was a mutually agreed result, it does not necessarily mean that this is what the court would otherwise have ordered.

In future actions brought by the SEC against crypto issuers, courts might affirmatively limit the extraterritorial application of U.S. law. For example, the *Telegram* opinion might be limited to its facts.[193] The April 1, 2020, order in *Telegram* by Judge Castel,[194] which explicitly applied the injunction globally, makes *Telegram* easily distinguishable from most other cases. Telegram did not raise many of its arguments against extraterritorial application until after the preliminary injunction was issued.[195] Future entrepreneurs and their counsel would

192. Final Judgment as to Defendant Kik Interactive Inc., U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc., No. 19 Civ. 5244 (S.D.N.Y. Oct. 21, 2020), https://www.docketalarm.com/cases/New_York_Southern_District_Court/1—19-cv-05244/U.S._Securities_and_Exchange_Commission_v._Kik_Interactive_Inc/90/.

193. Numerous commentators have observed how fact-specific Judge Castel's orders appear to be. The opinion itself suggests the fact-intensive nature of the necessary evaluation. As one commentator explained, "[a]ccording to the judge, *Howey* requires an examination of the entirety of the parties' understandings and expectations." Scott H. Kimpel, *SEC Wins Injunction in Telegram ICO Case*, HUNTON ANDREWS KURTH (Mar. 27, 2020), https://perma.cc/N422-44MK. Even those who generally applaud Judge Castel's approach recognize the limits of the opinion. *See, e.g.*, Peter Van Valkenburgh, *On SEC v. Telegram: The First Legal Test for a SAFT*, COIN CENTER (Mar. 25, 2020), https://perma.cc/U6LY-6NW7 ("[T]his will remain a fact-specific inquiry. We can only infer so much from the specific case of *Telegram*; other projects have very different facts."). The fact-specific nature of the ruling and the entire approach means, of course, that it is difficult to know how different cases will be decided. "As with any case at this stage of the judicial process, it is extremely difficult to know whether different facts would have yielded a different result, but there are certain facts highlighted by the *Telegram* court that make a different outcome possible." *Cooley Alert*, *supra* note 70.

194. Telegram Update, No. 19-cv-9439, 2020 WL 1547383 (S.D.N.Y. 2020).

195. Judge Castel seemed to go out of his way to chastise the Telegram attorneys for their failure to raise the arguments earlier in the process. After noting up front that "Telegram had a full and fair opportunity to explain why the relief sought by the SEC was overbroad or otherwise inappropriate," *id.* at *1, the Judge complained that "[o]ne would expect a party opposing a preliminary injunction to include an argument in its very fulsome submissions that the grant of the requested injunction would be needless, overbroad, unworkable, apply extraterritorially, or any other argument it wished." *Id.* at *2. As a result, the SEC was "deprived of the opportunity" to appropriately respond

be well advised to plan for and make any such arguments well before that stage.

In lieu of distinguishing the facts of *Telegram*, other courts could simply disagree with the rationale and/or the result of Judge Castel's orders. Given the uncertainties surrounding how the rules regarding extraterritorial enforcement of U.S. law should be applied,[196] future decisions might turn on a different interpretation of the law. A different judge or court might refuse to combine the initial phase of a SAFT distribution with the eventual token distribution, declining to treat the plan as a single offering or scheme.[197] Alternatively, future decisions might decline to apply U.S. securities laws to primarily extraterritorial transactions, such as sales of cryptoassets by a foreign issuer directed to individuals outside the U.S.[198]

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to the suggestions offered by Telegram. *Id.* This factual underpinning could be used to distinguish future cases, where presumably the arguments would be raised earlier.

196. *See supra* Part IV.B.

197. Even one of the SEC Commissioners would take this approach. Commissioner Hester Peirce, who has been the commissioner most receptive to blockchain technology and cryptoassets, in general, has suggested that there is a distinction between the two stages of a typical SAFT offering. According to various reports, she "believes that the initial investments in the company are to raise capital to build the platform, and that those initial investments are separate from the resale of a functional token '. . . such tokens, once they have a consumptive use, should be able to be sold to purchasers outside of a securities transaction.'" Rebecca Stoner, *Commissioner Hester Peirce Dissents on SEC Telegram Ruling and Settlement*, SECURITIES.IO, https://perma.cc/KHZ7-5CGW (last updated July 22, 2020). Commissioner Peirce's speech can be found at *Not Braking and Breaking*, *supra* note 175.

198. In addition to objecting to the way in which the *Howey* test was applied, SEC Commissioner Peirce also objected to the extraterritorial application of U.S. law in the *Telegram* case:

> Telegram was not a United States company, and its major operations were not in the United States. Only [thirty-nine] of the 175 accredited investors were in the United States, and those [thirty-nine] provided only about one-quarter of the funds raised in the private offering. Notwithstanding these facts, when the SEC sought a preliminary injunction, it asked the district court to enjoin Telegram from delivering Grams to "any persons."

Not Braking and Breaking, *supra* note 175. As Commissioner Peirce notes in the speech, this broad application of U.S. law "reasonably might raise some concerns among our international colleagues." *Id.* As a result, she urges caution in "asking for remedies that effectively impose our rules beyond our borders." *Id.*

Any hope that the appellate court would reverse or limit Judge Castel's decision on the preliminary injunction ceased when Telegram dropped its Second Circuit Appeal.[199] While this means Telegram is bound by the decision, appellate courts will still have the opportunity to reject Judge Castel's reasoning in future cases.[200] In fact, the decision of one appellate court is not necessarily binding on the other circuits, and it may take a decision from the Supreme Court to finally resolve how to interpret and apply the U.S. securities laws. A Supreme Court ruling on this issue could actually be good news for entrepreneurs, as the Court has increasingly signaled that its approval of and tolerance for the administrative state is waning.[201]

199. *See* Order, U.S. Sec. & Exch. Comm'n v. Telegram Grp. Inc., 1:19-cv-09439 (2d Cir. May 22, 2020) https://perma.cc/7P8J-K2F5. For a brief explanation of the circumstances surrounding this decision, see Benson Toti, *Telegram Drops TON Appeal in U.S. Court*, COINJOURNAL (May 25, 2020), https://perma.cc/QLD9-55U4.

200. Some commentators have, for example, suggested that courts could decide to apply *Howey* in a manner which differs from that advocated by the SEC or adopted by Judge Castel in his *Telegram* order. *See* M. Todd Henderson & Max Raskin, *A Regulatory Classification of Digital Assets: Toward an Operational* Howey *Test for Cryptocurrencies, ICOs, and Other Digital Assets*, 2019 COLUM. BUS. L. REV. 443, 489 (2019) (suggesting that courts should focus on two parts of the conventional test, the "efforts of others" and "expectation of profits" prongs). Under their approach, the second element, which the authors call the "Substantial Steps Test," would prevent an asset from being classified as a security if the promoters are making good faith efforts to develop a product reasonably intended to have functionality for some users beyond a profits interest. *Id.* at 489–91.

201. *See* Jeffry S. Lubbers, *Is the U.S. Supreme Court Becoming Hostile to the Administrative State?*, *in* 3 COMPARATIVE PERSPECTIVES ON ADMINISTRATIVE PROCEDURE 31 (Russel L. Weaver, Herwig C.H. Hofmann, Cheng-Yi Huang, & Steven I. Friedland eds., 2017); *see also* Gilliam E. Metzger, *1930s Redux: The Administrative State Under Siege*, 131 HARV. L. REV. 1 (2017) ("[T]he contemporary reality of delegation makes core features of the administrative state constitutionally obligatory."); Cass R. Sunstein & Adrian Vermeule, *The New Coke: On the Plural Aims of Administrative Law*, 2015 SUP. CT. REV. 41 (2015) (reviewing the range of attacks being levied against the administrative state); K. Sabeel Rahman, *Reconstructing the Administrative State in an Era of Economic and Democratic Crisis*, 131 HARV. L. REV. 1671 (2018) (reviewing JOHN D. MICHAELS, CONSTITUTIONAL COUP: PRIVATIZATION'S THREAT TO THE AMERICAN REPUBLIC (2017)). This movement is typified by recent decisions limiting *Chevron* deference, according less respect to informal agency positions, even if they have been held for a considerable period of time. *See* Edwin E. Huddleson, Chevron *Under Siege*, 58 U. LOUISVILLE L. REV. 17, 77 (2019) (acknowledging the need to address the problem of over-regulation but contending that the attacks on *Chevron* are over-broad).

Finally, even if the courts or the SEC do not independently change the way in which the securities laws are interpreted or applied, Congress could step in to mandate a different approach.[202] There have been numerous requests for such intervention from Congress even from crypto supporters, some of whom have warned that the U.S. will fall behind in innovation if regulatory clarity is not forthcoming.[203]

There are indications that some members of Congress are interested in crypto, as evidenced by the forty bills relating to some aspect of crypto that were introduced during the 2019–2020 legislative session.[204] Unfortunately, "interest" does not necessarily translate into legislators being sufficiently informed and motivated to actually adopt significant legislation. Of the crypto bills introduced in the 116th Session of Congress, most stalled in committee; only two were successfully adopted.[205] The two bills that were adopted were both part of

President Trump was very candid about his intent to nominate and place federal judges who oppose excess regulation and prefer to limit the power of regulatory agencies. *See, e.g.*, Jeremy W. Peters, *Trump's New Judicial Litmus Test: Shrinking 'The Administrative State'*, N.Y. TIMES, (Mar. 26, 2018), https://perma.cc/YT3H-JKGV ("It has been practically a given that anyone nominated for a federal judgeship by a Republican president had to pass an unspoken litmus test . . . . The Trump administration has a new litmus test: reining in what conservatives call 'the administrative state.'").

202. Various academic commentators have also suggested that legislative intervention would be desirable to avoid over-stifling innovation and entrepreneurship in the crypto sphere. *See, e.g.*, Carol Goforth, *Cinderella's Slipper: A Better Approach to Regulating Cryptoassets as Securities*, 17 HASTINGS BUS. L.J. 271 (2021). Some suggestions, such as the creation of a new regulatory agency, seem unlikely to gain much traction. *But see* Nathan J. Hochman, *Policing the Wild West of Cryptocurrency Part II*, 41 L.A. LAW. 26 (2018). Hochman argues it is now "time for Congress to create the CEC as the federal 'crypto-sheriff' to strike the right balance in reining in the Wild West of Cryptocurrency." *Id.* at 31. Another proposal has been to change the federal securities laws so that accredited institutional investors, and perhaps other wealthy investors with slightly reduced sophistication standards, can invest freely in cryptoassets. Shlomit Azgad-Tromer, *Crypto Securities: On the Risks of Investments in Blockchain-Based Assets and the Dilemmas of Securities Regulation*, 68 AM. U. L. REV. 69, 112–30 (2018).

203. *See* Kate Rooney, *Crypto Industry Leaders Warn Congress: Figure Out Regulation, or Watch Innovation Leave the U.S.*, CNBC, https://perma.cc/PAD3-9NXQ (last updated Sept. 26, 2018, 1:02 PM).

204. Jason Brett, *In 2019-2020, Congress Introduced 40 Crypto and Blockchain Bills*, FORBES (Oct. 17, 2020, 10:29 PM), https://perma.cc/S5F7-92G9.

205. *Id.*

much larger appropriations bills and essentially called for additional study and reports.[206] Only a few bills were passed by the House but not the Senate. Three of these bills would have created task forces to study how the Financial Crimes Enforcement Network (FinCEN) might use the same blockchain technology that underpins and supports cryptoassets to better combat money laundering and the funding of criminal activities, and three more would have dealt with use of cryptocurrencies in illegal activities.[207] None of the bills that attempted to help develop regulatory clarity made it out of committee. In this group of proposed acts, four bills would have addressed treatment of cryptoassets by regulatory authorities, two addressed various consumer protection issues, one covered state money transmission licenses, three addressed taxation issues, and three more focused on Facebook's proposed Libra coin.[208] The bills did not agree on the appropriate approach to take and none of them would have been particularly helpful to crypto entrepreneurs.

For example, the proposed Crypto-Currency Act of 2020 was an attempt to "provide clarity on the boundaries between relevant laws and regulatory authorities," but as others have noted, the new categories of cryptoassets would have been likely to "create new problems regarding boundaries, however, making them likely to sow further confusion rather than establish clarity."[209] Although it is possible that Congressional inaction was because the crypto bills in question were not seen as being helpful, the likely reality is that crypto and blockchain are still not understood by legislators.

On the other hand, a bill to address the extraterritorial application of U.S. securities laws does not need to focus on crypto. In 2010, Congress enacted legislation expanding the SEC's jurisdiction over

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206. One called for a briefing to Congress of how cryptocurrencies could impact economic sanctions, and the other called for information from the Department of Defense about potential applications for blockchain technology. *Id.*

207. *Id.*

208. Jason Brett & Whitney Kalmbach, *Cryptocurrency and Blockchain in the 116th Congress*, *in* GLOBAL LEGAL INSIGHTS, BLOCKCHAIN AND CRYPTOCURRENCY LAWS AND REGULATIONS 2021 (3d ed. 2021), https://perma.cc/5LMY-AGLU. Since the time of this proposal, Facebook's Libra has been rebranded as Meta's Diem. *See* Ariel Santos-Alborna, *Meta: Diem Is an Underrated Growth Catalyst*, SEEKING ALPHA (Dec. 1, 2021, 10:35 PM), https://perma.cc/XFM3-4UEB.

209. Robert Kim, *Analysis: A Crypto-Currency Act of 2020? You Cannot Be Serious!*, BLOOMBERG L. (Jan. 13, 2020, 5:38 AM), https://perma.cc/YV76-5G69.

certain extraterritorial conduct.[210] It did so with language that created some confusion as to the extent to which U.S. securities laws should be applied to transactions with an international focus.[211] Language clarifying and limiting the application of U.S. securities laws might be adopted to fix the confusion, although crypto enforcement could certainly be affected by such changes. Whether the SEC and Congress will have the will to make such changes is completely uncertain, although, as noted above, there are good reasons for such a change in direction.

Given the range of future possibilities, it is not realistic to try to predict what will happen next with regard to the application of U.S. securities laws to crypto distributions. Still, there are reasons to hope that future developments move away from the approach taken by Judge Castel.

V. CONCLUSION

It is true that Judge Castel's order in *SEC v. Telegram*[212] was thoughtful and thorough. Despite this, the way in which he ordered the extraterritorial application of U.S. securities laws to cryptotransactions creates a range of problems. First, such aggressive enforcement efforts encourage more crypto businesses to attempt to avoid any presence in the U.S.,[213] meaning both that U.S. investors will be denied the opportunity to participate in various new opportunities and that the U.S. is likely to be left behind with regard to technological development and innovation. Second, from the point of view of entrepreneurs, this approach could diminish the availability of funding,[214] also slowing the pace of innovation.

210. *See supra* notes 129–37 and accompanying text.

211. For a discussion of the drafting ambiguities contained within the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 provision, *see supra* notes 131–35.

212. Telegram Order, 448 F. Supp. 3d 353 (S.D.N.Y. 2020).

213. *See supra* Part II.B. While the extraterritorial application of U.S. laws might be suspected of creating problems even for such efforts, if there is no presence in the U.S., it would be difficult for authorities here to obtain practical jurisdiction over such businesses or their assets.

214. *See supra* notes 64–66 and accompanying text.

A third problem is that in addition to the increased burden on U.S. investors and companies, trying to enforce U.S. laws across the world may ironically result in a diminished role and decreased influence for the U.S., as other nations resent interference with their own priorities and efforts.[215] Fourth, to the extent that the U.S. insists on imposing its view and priorities on other nations, this will inevitably lead to significantly reduced incentives to create international consensus.[216] Finally, given that the U.S. priorities and rules will overlap with the laws of other nations, and will necessarily include inconsistent rules, the result will be an even less desirable regulatory environment for crypto businesses.[217]

This Article therefore suggests that the SEC, the courts, or Congress should act to focus crypto enforcement efforts on actions which originate in the U.S. or that are directed to U.S. investors. Continuation along the current path is only likely to stifle desirable innovation and development, along with the economic growth it can bring, especially in the U.S.

215. *See supra* notes 161–65 and accompanying text.

216. *See supra* notes 166–69 and accompanying text.

217. *See supra* notes 156–60 & 165–70 and accompanying text.