Learnings From Early Crypto Token Securities Class Actions

Plaintiffs from around the world have recently filed dozens of class-action lawsuits in U.S. federal and state courts contending that crypto token developers and platforms have sold unregistered securities in violation of the Securities Act of 1933. Defendants in these cases have successfully relied on Supreme Court and appellate court precedents to defeat claims at the pleading stage, generally before addressing the *Howey* test for whether a token is a security to which the Securities Act applies. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946). Recent decisions demonstrate that defendants' positions are especially strong—and generally insurmountable—if the crypto token developer or platform on which the plaintiff purchased is based outside the United States. But these cases have also shown that even in cases in which there are stronger ties to the United States may be subject to important limitations under the federal securities laws.

I. The 'BProtocol' Case and Decision

The current wave of crypto-securities suits began in early 2020. On April 3, 2020, plaintiffs' firms filed 11 simultaneous suits in the Southern District of New York against seven crypto token developers and four crypto platforms. All suits alleged the same theory: that defendants owed damages or rescission to purchasers who bought crypto tokens, often long after initial offerings and on foreign platforms, because those tokens were unregistered securities.

We represented defendants in three of these suits, including in the first to be decided, *Holsworth v. BProtocol Found.*, No. 20-CIV-2810, 2021 WL 706549 (S.D.N.Y. Feb. 22, 2021) (*BProtocol*). *BProtocol* has since become a bellwether case. It established more than a half-dozen obstacles to these types of private claims.

In *BProtocol*, a plaintiff from Wisconsin, Timothy Holsworth, alleged he had purchased the crypto token BNT through a platform based in Singapore. He brought claims against B.Protocol, a blockchain-focused nonprofit founded by Israelis and based in Switzerland, for selling BNT. Holsworth alleged that B.Protocol violated §5 of the Securities Act by selling BNT in unregistered securities offerings, giving rise to a private right of action under §12(a)(1). Id. at *1. Holsworth contended he was entitled to rescission with interest, as he had not resold his BNT, and that other putative class members would be entitled to damages if they had sold BNT at a loss. See id. at *1-2, 15 U.S.C. §77l(a)(1). Holsworth also brought 100 state Blue Sky claims under the laws of all available states under the same theory. *BProtocol* at *1. The complaint spanned 1,011 paragraphs covering 193 pages.

On a motion to dismiss under FRCP 12(b)(6), B.Protocol offered numerous reasons that plaintiff's claims could not proceed, and Judge Alvin Hellerstein agreed. After the decision, Holsworth's counsel considered but then dropped an appeal to the Second Circuit, and soon thereafter voluntarily dismissed numerous parallel claims against other crypto token developers and platforms. See, e.g., Notice of Voluntary Dismissal, *Chua v. Civic Tech.*, 20-cv-02811 (S.D.N.Y. April 29, 2021), ECF No. 60; Notice of Voluntary Dismissal, *Kuzmeskas v. Quantstamp*, 20-cv-02813 (S.D.N.Y. April 29, 2021), ECF No. 52. Judge Hellerstein's decision has been cited in cases litigated throughout the United States.

Below we review the key lessons that *BProtocol* offers to courts adjudicating crypto securities cases, to crypto industry participants in defending them, and to plaintiffs in considering whether to bring claims in U.S. courts.

II. Lessons From 'BProtocol' and Cases Since

Standing. The *BProtocol* court found that Holsworth, whose tokens had risen in value since he bought them, lacked Article III standing. *BProtocol* at *2. Holsworth had contended that the Securities Act entitled him to rescission of his BNT purchases regardless of the tokens' price history. The court disagreed. It held that even when requesting rescission, a plaintiff must demonstrate actual injury. Id. (citing *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 560 (1992)). Statutory Seller. A separate and critical ground for dismissal was that Holsworth had not alleged B.Protocol was a "statutory seller" to him as *Pinter v. Dahl*, 486 U.S. 622, 644-47, 650-51 (1988), requires for §12(a)(1) claims. Id. at *3. The court ruled that a plaintiff may bring a §12(a)(1) claim only if he or she (1) received title directly from the defendant (the "privity prong") or (2) was "directly contacted" by the defendant and "purchased securities as a result" (the "solicitation prong"). Id. This bar is higher than for familiar §10(b) claims under the Securities Exchange Act of 1934 because the sale of unregistered securities is a strict liability offense. See, e.g., *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 360 (2d Cir. 2010) (observing that Securities Act claims "apply more narrowly but give rise to liability more readily" than 10(b) claims).

BProtocol's interpretation of the second solicitation prong of the statutory seller standard, on which most crypto securities complaints rely, was particularly important. Before *BProtocol*, two decisions held that plaintiffs can satisfy the solicitation prong simply by alleging defendants posted Tweets, blog posts, or other indirect promotional statements, and without alleging the plaintiff's knowledge of or reliance on those statements. But these cases employed a standard for solicitation that *Pinter* abrogated. The first, *Balestra v. ATBCOIN*, quoted and applied an interpretation of the standard that dated nearly five decades before *Pinter*. 380 F. Supp. 3d 340, 358 (S.D.N.Y. 2019) (*Balestra*) (quoting *SEC v. Chinese Consol. Benevolent Ass'n*, 120 F.2d 738, 741 (2d Cir. 1941). The second, *Zakinov v. Ripple Labs*, cited only *Balestra* in applying the same abrogated test. No. 18-CV-06753, 2020 WL 922815, at *12 (N.D. Cal. Feb. 26, 2020); see also *Owen v. Elastos Found.*, No. 19-CV-5462, 2021 WL 5868171, at *15 n.6 (S.D.N.Y. Dec. 9, 2021) (recognizing *Balestra*'s misplaced reliance on *Chinese Consol.*).

The *BProtocol* court declined to follow these earlier cases and held that plaintiffs relying on the second solicitation prong of the statutory seller standard must allege that plaintiffs (a) had "direct contact[]" with the defendants and (b) "purchased securities as a result of any active solicitations" by defendants. *BProtocol* at *3. In support of this holding, *BProtocol* relied on *Capri v. Murphy*, 856 F.2d 473, 478-79 (2d Cir. 1988), which held that plaintiffs must allege that a defendant successfully solicited the plaintiff's investment. Under this standard, allegations that BProtocol had engaged in general marketing on which plaintiff never relied were insufficient. See *BProtocol* at *1, 3.

Since *BProtocol*, *Ocampo v. Dfinity USA Rsch.*, litigated in California state court, has likewise recognized that only defendants who "directly or immediately solicited [the plaintiff's] purchase of the tokens" can be held liable under §12(a)(1) and that "the necessary inquiry focuses on the defendant's relationship with the plaintiff-purchaser, not the defendant's degree of involvement in the securities transaction and its surrounding circumstances." No. 21-CIV-03843 (Cal. Super. Ct. April 7, 2022)

(*Dfinity*) (quotations and alterations omitted) (citing *Jensen v. iShares Tr.*, 44 Cal. App. 5th 618, 648-49 (Cal. Ct. App. 2020)).

'Morrison'. *BProtocol* and several subsequent cases have held that *Morrison v. Nat'l Austrl. Bank Ltd.*, 561 U.S. 247 (2010), bars suits by plaintiffs whose only transactions occurred on foreign crypto platforms. *BProtocol* at *3; *Dfinity* at *6; *Anderson v. Binance*, No. 20-CV-2803, 2022 WL 976824, at *4 (S.D.N.Y. March 31, 2022) (*Binance*). *Morrison* held that U.S. securities laws apply only to (a) transactions listed on domestic exchanges or (b) domestic transactions in other securities. *Morrison*, 561 U.S. at 267. Courts have held that the first prong is satisfied only if transactions occur on registered national securities exchanges. *Binance* at *4. Since no crypto token platform is currently registered, crypto securities cases can proceed only if the second prong is satisfied—that is, only if "'irrevocable liability is incurred or title passes within the United States.'" Id. (quoting *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 66, 67 (2d Cir. 2012)). In crypto cases, courts have held that plaintiffs located in the United States who bought tokens through platforms located abroad cannot meet this standard, even if some of the platforms' servers were in the United States. See *Binance* at *4; *BProtocol* at *3; *Dfinity* at *6. There appears to be no doubt that claims based on crypto token purchases on foreign platforms may not be litigated in U.S. courts.

Statute of Limitations. *BProtocol* and subsequent cases have held that §12 violations have a strict one-year statute of limitations with no discovery-rule tolling for later-learned facts or tolling for later-learned legal interpretations. *BProtocol* at *3; *In re Bibox Grp. Holdings Ltd. Sec. Litig.*, 534 F. Supp. 3d 326, 339 (S.D.N.Y. 2021) (*Bibox*) (citing *Rotkiske v. Klemm*, 140 S. Ct. 355, 361 (2019)); *Binance* at *2. And courts have rejected the argument that crypto token developers and platforms fraudulently concealed that crypto tokens could be deemed securities by stating that the tokens were not securities, holding that a potential and uncertain legal conclusion cannot be a fraudulently concealed fact. *Bibox* at 339-40.

Personal Jurisdiction and Forum Non Conveniens. *BProtocol* illustrates that crypto token developers and platforms based abroad can successfully argue that U.S. courts lack personal jurisdiction or are inconvenient fora. The *BProtocol* court found that it had no specific personal jurisdiction over a Swiss nonprofit or individual Israeli citizens even though defendants had allegedly attended conferences promoting the BNT token in New York. *BProtocol* at *1-2. The court's reasoning intersected with the standard for a solicitation statutory seller: Because plaintiff alleged neither direct contact between himself and defendants nor reliance on any statements by defendants in choosing to purchase, allegations that defendants made promotional statements in New York lacked any causal relationship to plaintiff's alleged injury. Id. at *2. But this inquiry is case-specific and fact-intensive. Specific personal jurisdiction over other international crypto token developers in other securities cases has been upheld. See *SEC v. Terraform Labs PTE Ltd.*, No. 22-368, 2022 WL 2066414, at *3-4 (2d Cir. June 8, 2022) (noting that defendants retained U.S.-based employees and entered into agreements with U.S.-based entities to facilitate token trading). *BProtocol* further recognized that even if the court had personal jurisdiction, the U.S. would be the wrong forum for the case given its extensive international connections. *BProtocol* at *3.

Blue Sky Claims. Finally, as to the 100 state Blue Sky claims, Judge Hellerstein chastised Holsworth for bringing claims for which he alleged no "connection between the security and the regulatory reach of the state agency[.]" Id. Other cases have likewise held that plaintiffs cannot bring Blue Sky claims where "there is an insufficient nexus between the allegations" and the state, since

"Blue Sky laws only regulate transactions occurring within the regulating States." *Binance* at *4 (quotation and alteration omitted); see also *Bibox* at 334.

III. Looking Ahead

For years, the Securities and Exchange Commission has argued that under the Supreme Court's *Howey* test for whether an instrument is an investment contract, numerous crypto tokens should classify as securities subject to the Securities Act. See, e.g., *SEC v. Telegram Grp.*, 448 F. Supp. 3d 352, 358 (S.D.N.Y. 2020). Given the SEC's position, plaintiffs filing follow-on cases likely expected to be able to litigate whether individual crypto tokens are securities to which the Securities Act applies. But a critical takeaway from *BProtocol* and subsequent decisions is that other appellate precedents, when applied to crypto token trading, raise many pleading-stage obstacles to private suits that courts will likely address before reaching the *Howey* test. While some future defendants may raise *Howey* earlier in the life of a case—for instance, if tokens at issue are stablecoins—we expect the several successful defenses raised in *BProtocol* will continue to be central to crypto token securities litigation, especially the limitations imposed by the statutory seller standard. And we expect plaintiffs to focus more attention on U.S. platforms, developers, and transactions, and to become increasingly creative in their pleadings.

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