MORRISON AND CRYPTOCURRENCIES: IS IT TIME TO REVISIT THE EXTRATERRITORIAL APPLICATION OF RULE 10B-5?

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I. INTRODUCTION

Recently, cryptocurrencies have been the topic of discussion everywhere from boardrooms to celebrities' social media accounts. They are a new form of investing that seems to make money magically appear, but is it too good to be true? Global regulators are unsure of how these new cryptocurrencies should be treated.[1] The United States Securities and Exchange Commission (SEC) has taken a position on the matter and declared that some of these investments are considered "securities" under U.S. law, meaning they are subject to the vigorous securities regulation regime.[2] Declaring these investments securities adds a layer of protection to investors who might fall victim of fraud resulting from cryptocurrencies.[3]

The United States is not the only country that has taken notice of the potential need for regulation in the cryptocurrency markets. Regulators in Asia have also responded to the growing cryptocurrency market.[4] China has banned initial coin offerings (ICOs), discussed below, and closed cryptocurrency exchanges over concerns of fraud.[5] South Korean regulators have begun investigating cryptocurrency-related compliance in large banks and have also prohibited ICOs.[6] Australian legislators are considering legislation which would put regulation of cryptocurrencies within the reach of AUSTRAC, Australia's financial intelligence agency.[7]

Regulatory bodies across the globe have not been uniform in responding to cryptocurrencies.[8] How can investors have any confidence in the market with so much uncertainty? Opening U.S. tribunals, and thus its securities

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[1] *See* LAW LIBRARY OF CONG., REGULATION OF CRYPTOCURRENCY AROUND THE WORLD (2018) (demonstrating the differences between cryptocurrency regulations over the world).

[2] *See* Kate Rooney, *SEC Chief Says Agency Won't Change Securities Laws to Cater to Cryptocurrencies*, CNBC (June 11, 2018), https://www.cnbc.com/2018/06/06/sec-chairman-clayton-says-agency-wont-change-definition-of-a-security.html (reporting that SEC chairman Jay Clayton said that the SEC will not change the definition of a security to cater to the new cryptocurrency markets and under the current definition of a security, tokens used in an initial coin offering are securities).

[3] *See What We Do,* U.S. SEC. & EXCH. COMM'N (June 10, 2013), https://www.sec.gov/Article/whatwedo.html (explaining how SEC regulations help investors as part of their trifold mission of "protect[ing] investors, maintain[ing] fair, orderly and efficient markets, and facilitate[ing] capital formation").

[4] *See* Carlos M. Gutierrez, Jr., *Asia Takes the Lead in Regulating Cryptocurrency Markets*, ASIA TIMES (Jan. 10, 2018), http://www.atimes.com/asia-leads-way-cryptocurrency-regulation/.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *See generally* REGULATION OF CRYPTOCURRENCY AROUND THE WORLD, *supra* note 1 (showing how different regions are regulating the cryptocurrency markets completely differently).

antifraud regime, to investors who have been harmed in fraudulent cryptocurrency transactions may increase investor confidence and potentially foster capital markets.[9] There are two ways that the United States deters fraudulent securities transactions.[10] First, our securities regulation regime allows the SEC to bring enforcement action and, second, for individuals to bring private rights of action.[11]

This Note aims to evaluate how the doctrine of extraterritoriality applies to securities regulation in the cryptocurrency market. Specifically, this Note will examine how the extraterritorial application of Rule 10b-5 applies to the emerging cryptocurrency market for both SEC enforcement actions and private rights of actions. Part I will provide some background information about what a cryptocurrency is and how Initial Coin Offerings (ICOs) work. Part II will discuss how the U.S. defines a security that falls within our regulation regime, how some Initial Coin Offerings fall within the purview of our securities regime, and how the SEC has responded to Initial Coin Offerings. Part III will discuss the current state of the law of extraterritorial application of securities regulation, both for SEC enforcement actions and private actions. Finally, Part IV will provide some analysis about the future of private 10b-5 causes of action for foreign investors.

II. BACKGROUND

A. Cryptocurrencies

To begin the inquiry into the extraterritorial application of U.S. securities law in the context of cryptocurrency markets, the first step is understanding what cryptocurrencies are. Both cryptocurrency and traditional forms of currency are only as valuable as society believes they are. Traditional currencies' bills and coins are just tokens we use to exchange goods and services based on how valuable we believe it is.[12] Cash has no inherent value; it is a piece of paper.[13] As technology has developed over the years, there is no longer a need for currency to take the form of a physical token, like cash.[14] Transactions began moving away from a physical token of currency long before

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[9] STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 9 (Robert C. Clark et al. eds., 4th ed. 2015) (noting that U.S. securities laws foster transparency and accuracy which is helpful to the capital markets).

[10] *See generally* Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PENN. L. REV. 2173 (2010).

[11] *Id.*

[12] Martin Tillier, *What is a Cryptocurrency?*, NASDAQ (Jan. 25, 2018), https://www.nasdaq.com/article/what-is-a-cryptocurrency-cm910816.

[13] *Id.*

[14] *Id.*

cryptocurrencies were even an idea.[15] This is illustrated by the development of written checks and eventually debit cards.[16] No cash ever changes hands in transactions involving these methods.[17] The bank simply reduces your balance and increases someone else's by updating a ledger. [18]

Cryptocurrencies are somewhat similar to the idea of debit cards and written checks, but there are some key differences.[19] First, they are not backed by a government.[20] Instead, cryptocurrencies are created and controlled by algorithms.[21] The algorithms determine how transactions are made and recorded and how new cryptocurrencies are released.[22] Instead of completing transactions through banks or another intermediary, cryptocurrency users and their recorded transactions create a system known as the blockchain.[23] This blockchain system of "peer-to-peer" transactions instead of government issued currencies is the first major distinction between traditional currencies and cryptocurrencies.[24]

The second difference is that the total amount of a cryptocurrency in circulation is limited.[25] This differs from traditional currency because governments can, and do, simply print more money to increase the amount in circulation.[26] As economies grow, governments create more currency to allow for the growth.[27] Adding more currency into the circulation of that currency is what causes inflation.[28] Because of this, traditional currencies are based on an inflationary model.[29] Cryptocurrencies, on the other hand, are exactly the opposite because they operate on a deflationary model.[30] The total supply of a cryptocurrency in circulation is restricted.[31] As the economy grows, instead of adding more cryptocurrency into circulation, each unit of cryptocurrency has more buying power than it previously had.[32] For example, something that

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[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*

costs one unit of cryptocurrency today will cost a fraction of the same unit as time passes and the economy grows.[33]

B. Initial Coin Offerings

On its face, the concept of cryptocurrency might seem to be outside of the SEC's scope of enforcement. However, the concept of initial coin offerings (ICOs) makes it clear that cryptocurrencies are within the SEC's scope of power. Promoters have been selling virtual tokens, a unit of cryptocurrency, in ICOs.[34] Those who wish to purchase the virtual tokens through an ICO can use traditional currency to make their purchase.[35] Sometimes these promoters lead purchasers to believe that they will receive a return on their investment.[36] Sometimes those in need of capital (i.e. start-ups or online projects) use ICOs as a way to raise capital without going through the hassle of issuing stock or finding venture capitalists to invest.[37] In this regard, ICOs are similar to crowdfunding,[38] which is regulated by the SEC.[39]

C. The Howey *Test*

The Securities Act of 1933 (Securities Act) defines what a security is.[40] That definition includes a catchall provision listing "investment contracts" as a security falling within the purview of the Securities Act and the Securities Exchange Act of 1934 (Exchange Act).[41] In 1946, the Supreme Court gave guidance on what the broad sweeping "investment contract" means.[42] An investment contract, and thus a security within the reach of the SEC's

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[33] *Id.*

[34] *Investor Bulletin: Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (July 25, 2017), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings.

[35] *Id.*

[36] *Id.*

[37] Nathaniel Popper, *An Explanation of Initial Coin Offerings*, N.Y. TIMES (Oct. 27, 2017), https://www.nytimes.com/2017/10/27/technology/what-is-an-initial-coin-offering.html.

[38] *Id.*

[39] *See generally Regulation Crowdfunding*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding.

[40] Securities Act of 1933, 15 U.S.C.A. §77b(a)(1) (2012) (defining the term "security" for purposes of the Act).

[41] *Id.*; *see also* CHOI & PRITCHARD, *supra* note 9, at 97 (explaining that the reason the inclusion of "investment contracts" in the definition of a security makes the SEC's power broad by leaving the definition of investment contract up for interpretation).

[42] *See generally* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

regulation, is any instrument that meets the requirements of the *Howey* test.[43] The *Howey* test was established in *SEC v. W.J. Howey Co.*[44] The defendants in that case were two Florida corporations under the same control and management.[45] The company owned large tracts of citrus farms in Florida. Leading up to the case, the company would offer up half of its acreage to the public to "help [them] finance additional development."[46]

Each prospective customer was offered both a land sale and service contract.[47] The land sale contract allowed the purchasers to get a portion of the acreage of the citrus farm.[48] The service contract allowed Howey's other company, one under the same management and control, to cultivate the land, making it profitable for the purchaser.[49] Additionally, the company told potential buyers that it was not feasible to invest in a land contract unless they also purchase the service contract.[50] The service contract gave the cultivating company a leasehold interest in the purchased land and "full and complete" possession for ten years with no cancellation option.[51]

The purchasers were mostly out-of-state residents and professionals with no knowledge or skills necessary to cultivate a citrus farm.[52] The court speculated that purchasers were attracted by the arrangement because of the expectation of profits, not because they were interested in cultivating citrus trees.[53] Were the Securities Act and the Exchange Act intended to regulate these kinds of investing instruments? The court took the opportunity to not only decide this case, but to create a test for future inquiries into defining investment contracts.[54]

The court concluded in *Howey* that the sales and service contracts taken together constituted an investment contract.[55] Thus, the investors in the citrus farm could turn to the Securities Act and the Exchange Act for protection.[56] The court looked to the Congressional intent of defining securities and noted that

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[43] *Id.* at 297 (stating that an affirmative answer to whether the contract was an investment contract brings into operation the registration requirement of the Act).

[44] *Id.* at 301 ("[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.").

[45] *Id.* at 294–95.

[46] *Id.* at 295.

[47] SEC v. W.J. Howey Co., 328 U.S. 293, 294 (1946).

[48] *Id.* at 295.

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] SEC v. W.J. Howey Co., 328 U.S. 293, 296–97 (1946).

[53] *Id.*

[54] *Id.* at 301 (establishing a test that is still used today).

[55] *Id.* at 299.

[56] *Id.* at 300.

> [t]he term "investment contract" is undefined by the Securities Act or by relevant legislative reports. But, the term was common in many state "blue sky" laws in existence prior to the adoption of the federal statute and, although the term was also undefined by those state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." This definition was uniformly applied by state courts to a variety of situations where individuals were *led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves*.[57]

By including "investment contract," a concept that had been utilized by states before federal regulation of securities, in the definition of a security, the court held that Congress intended to use the same "investment contract" that had been "crystallized by [its] prior judicial interpretation."[58] Thus,

> 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, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[59]

D. Howey *Test and Cryptocurrencies—The DAO Report*

The recent buzz over cryptocurrencies led SEC chairman Jay Clayton to make a public statement regarding cryptocurrencies and ICOs.[60] Prior to the statement, the SEC's Division of Enforcement had investigated a

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[57] *Id.* at 298 (citations omitted) (emphasis added).

[58] SEC. v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

[59] *Id.* at 298–99.

[60] S*ee* Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017) https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 ("The world's social media platforms and financial markets are abuzz about cryptocurrencies and [ICOs].").

Decentralized Autonomous Organization (DAO).[61] The SEC's investigation had to answer a threshold question to determine the application of U.S. securities laws to the offer and sale of DAO Tokens: Are DAO Tokens securities?[62] The SEC determined the DAO Tokens were securities.[63] The report that followed the DAO investigation (DAO Report) "reiterate[d the] fundamental principles of the U.S. federal securities laws and describe[d] their applicability to a new paradigm—virtual organizations or capital raising entities that use distributed ledger or blockchain technology to facilitate capital raising and/or investment and the related offer and sale of securities."[64] In the DAO Report, the SEC used the Howey test to determine whether these new form of investment instruments were securities within the reach of U.S. securities laws.[65]

The first element of the *Howey* test is whether investors invested money.[66] The SEC determined that this element was satisfied in the DAO.[67] Investors in the DAO used Ethereum (ETH), a cryptocurrency, to purchase the DAO Tokens.[68] This was sufficient to satisfy the "investment of money" requirement because "money" does not need to take the form of cash.[69]

The second and third elements of the *Howey* test require that investors put their money into a "common enterprise" and that they do so reasonably expecting profits.[70] The DAO Report analyzed these two elements of the *Howey* test together to determine that investments in the DAO token did, in fact, invest in a common enterprise with a reasonable expectation of profits.[71] Some promotional materials disseminated by the DAO told investors that the program "was a for-profit entity whose objective was to fund projects in exchange for a *return on investment*."[72] The ETH paid by investors in exchange for the

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[61] SEC. & EXCHANGE COMM'N, Release No. 81207, REP. OF THE INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SEC. EXCHANGE ACT OF 1934: THE DAO (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf (explaining that DAO is a broad term used to describe a virtual organization comprised of computer code whose transactions are executed over a blockchain) [hereinafter DAO Report].

[62] *Id.* at 1.

[63] *Id.*

[64] *Id.* at 2.

[65] *Id.*

[66] SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946) (defining a security as partially the "investment of money . . . .").

[67] DAO Report, *supra* note 61, at 11.

[68] *Id.* at 2–3, 11.

[69] *Id.* (citing Uselton v. Comm. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991) ("[I]n spite of *Howey's* reference to an 'investment of money,' it is well established that cash is not the only form of contribution or investment that will create an investment contract.").

[70] Howey, 328 U.S. at 298–99.

[71] DAO Report, *supra* note 61, at 11.

[72] *Id.* at 11–12 (emphasis added).

DAO Tokens were "pooled and available to the DAO to fund projects."[73] The DAO Token holders could share in any profits from the projects executed by the pooled funds. The SEC determined this meant "a reasonable investor would have been motivated, at least in part, by the prospect of profits on their investment of ETH in The DAO."[74]

The fourth and final element of the *Howey* test is that the profit is "derived from the managerial efforts of others."[75] The SEC determined that the DAO also met this element.[76] This element requires that the efforts made by others are significant in that they are the managerial efforts which affect the failure or success of the enterprise.[77] "The investors' profits were to be derived from the managerial efforts" of the company's co-founders.[78] Even though the investors were awarded voting rights, the SEC nevertheless concluded that the managerial efforts of others ultimately determined the success of the enterprise.[79] The voting power awarded to the investors was limited, so the investors were still substantially reliant on others for their profits.[80]

E. SEC Response

Other than the DAO Report, the SEC has taken more measures to be proactive with the rise in technology and the emerging cryptocurrency market.[81] In 2017, music producer DJ Khaled and boxer Floyd Mayweather caught the SEC's attention.[82] Both celebrities promoted Centra Tech's ICO on their social media accounts.[83] The SEC separately charged Centra Tech with performing a fraudulent ICO.[84] Khaled and Mayweather failed to disclose that they had been paid $50,000 and $100,000, respectively, by Centra Tech to promote the allegedly fraudulent ICO.[85] The SEC has since warned consumers to be

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[73] *Id.* at 12.
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.* at 13.
[80] *Id.* at 13–14.
[81] *Oversight of the SEC's Division of Enforcement*, U.S. SEC. & EXCH. COMM'N (May 16, 2018), https://www.sec.gov/news/testimony/testimony-oversight-secs-division-enforcement (referring to multiple instances where the SEC Division of Enforcement helped investors by taking measures to prevent or restrain fraudulent ICOs).
[82] *Two Celebrities Charged with Unlawfully Touting Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Nov. 29, 2018), https://www.sec.gov/news/press-release/2018-268.
[83] *Id.*
[84] *Id.*
[85] *Id.*

especially cautious with ICOs that are endorsed by celebrities.[86] In this specific case, the SEC is concerned that the celebrities' failure to disclose the payments would make the endorsements appear to be unbiased, rather than a paid endorsement.[87] Although both Khaled and Mayweather have settled with the SEC, this investigation illustrates that the SEC is taking these potentially fraudulent ICOs very seriously.[88] The charges against Khaled and Mayweather were the first charges brought by the SEC against individuals for promoting ICOs.[89]

Additionally, a new unit within the Division of Enforcement, the Cyber Unit, has taken action to address ICOs and cryptocurrencies since the publication of the DAO Report.[90] For instance, the SEC issued a statement saying, "[w]hen market participants engage in fraud under the guise of offering digital instruments—whether characterized as virtual currencies, coins, tokens, or the like—the SEC . . . will look beyond form, examine the substance of the activity and prosecute violations of the federal securities . . . laws."[91] The Cyber Unit has also brought a number of enforcement actions relating to ICOs.[92] One enforcement action was halting an ICO which was selling digital tokens to its investors to raise capital for projects using blockchain to provide a food review service.[93] The SEC contacted the company to inform them that their conduct constituted unregistered securities offers and sales.[94] The company subsequently halted its ICO and refunded its investors all proceeds raised before any tokens were offered.[95] The SEC intervened because over the course of the offering, promoters emphasized that the investors could expect efforts of the company to lead to a value increase in their tokens.[96]

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[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.*

[90] U.S. SEC. & EXCH. COMM'N, *supra* note 81.

[91] *Joint Statement by SEC and CFTC Enforcement Directors Regarding Virtual Currency Enforcement Actions,* U.S. SEC. & EXCH. COMM'N (Jan. 19, 2018), https://www.sec.gov/news/public-statement/joint-statement-sec-and-cftc-enforcement-directors.

[92] U.S. SEC. & EXCH. COMM'N, *supra* note 81.

[93] *Company Halts ICO After SEC Raises Registration Concerns*, 2012-227, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017), https://www.sec.gov/news/press-release/2017-227.

[94] *Id.*

[95] *Id.*

[96] *Id.*; *see also* SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (this promotional promise, coupled with the investors putting in money to the common enterprise of the company, satisfies the four elements of the *Howey* test, thus enabling the SEC to step in and issue a cease and desist.).

III. CURRENT STATE OF THE LAW

As a general principle, legislation of Congress is meant only to apply within the territorial jurisdiction of the United States, absent a contrary intent by Congress.[97] Thus, unless there is an affirmative intention of Congress clearly expressed giving a statute extraterritorial effect, courts presume it is primarily concerned with domestic conditions.[98] Simply put, when a statute does not give a clear indication of an extraterritorial application, there is a presumption excluding any extraterritoriality.[99]

A. The Securities and Exchange Acts

The Securities and Exchange Acts contain antifraud provisions which can be utilized by the SEC to bring enforcement actions and by plaintiffs to bring a private right of action when they have been harmed by fraudulent securities transactions.[100] The Securities Act and Exchange Acts were passed in response to the stock market crash in 1929, which was widely believed to be caused by fraudulent securities activities.[101] As such, the antifraud provisions supplied by both the Securities Act and Exchange Act are written liberally in attempt to protect investors.[102] Section 11 of the Securities Act allows for liability when a registration statement contains "an untrue statement of material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . ."[103] Section 12(a)(2) of the Securities Act, on the other hand, creates civil liability for material omissions or misstatements in securities offerings and sales made by "means of a prospectus or oral communication."[104]

The Exchange Act also contains antifraud provisions. These antifraud provisions focus more on the conduct in the markets, as opposed to the Securities Act's antifraud focus on preventing fraud within the registration and disclosure process.[105] An antifraud provision from the Exchange Act brings an

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[97] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010).

[98] *Id.*

[99] *Id.*

[100] Joshua L. Boehm, *Private Securities Fraud Litigation After* Morrison v. National Austl. Bank*: Reconsidering a Reliance-Based Approach to Extraterritoriality*, 53 HARV. INT'L L.J. 249, 252 (2012).

[101] *Id.*

[102] *Id.*

[103] Securities Act of 1933, 15 U.S.C.A. §77k(a) (2012).

[104] Securities Act of 1933, 15 U.S.C.A. §77l(a)(2) (2012).

[105] Boehm, *supra* note 100.

overwhelming majority of securities fraud cases: §10(b) of the Exchange Act and its implementing regulation, Rule 10b-5.[106]

B. §10(b) and Rule 10b-5

Since the vast majority of securities fraud class actions are brought as Rule 10b-5 complaints,[107] this note will focus on the 10b-5 fraud cause of action and its extraterritorial reach to the cryptocurrency market. Before explaining the law's extraterritorial application, one must understand that law. Rule 10b-5 antifraud liability mirrors the common law fraud claim. To establish a 10b-5 cause of action, a plaintiff must prove that there was either a material misstatement or omission, scienter, reliance, causation, and harm.[108]

Rule 10b-5 is widely regarded as a catch-all provision to deter fraudulent activity in the capital markets.[109] It might seem strange that Rule 10b-5 is considered the catch-all antifraud provision because it requires plaintiffs to carry a higher burden of proving that the defendant acted with scienter.[110] Nevertheless, Rule 10b-5 allows more claims than other antifraud securities laws because the rule has fewer restrictions than other antifraud provisions.[111]

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[106] Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUMB. L. REV. 1301, 1302 (2008).

[107] *Id.*

[108] *See Section 10(b) Litigation: The Current Landscape*, AMERICAN BAR ASS'N (June 29, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2014/10/03_kasner/ (explaining that "[t]o establish liability under §10(b), a plaintiff must show that: [t]he defendant made a material misstatement or omission; [t]he misstatement or omission was made . . . with scienter; [t]here is a connection between the misrepresentation or omission and the plaintiff's purchase or sale of a security; [t]he plaintiff relied on the misstatement or omission; [t]he plaintiff suffered economic loss; and [t]here is a causal connection between the material misrepresentation or omission and the plaintiff's loss.").

[109] *See e.g.*, Douglas C. Conroy, Michael L. Zuppone & David J. Kaplan, *SEC Anti-Fraud Rule 10b-5 Broadly Construed by Supreme Cour*t, PAUL HASTINGS (July 1, 2002), https://www.paulhastings.com/publications-items/details/?id=36adde69-2334-6428-811c-ff00004cbded (referring to SEC's Rule 10b-5 as a "catch-all" antifraud provision).

[110] *See Section 10(b) Litigation: The Current Landscape*, *supra* note 108 (listing that a misstatement or omission be made with scienter as one of the elements of a 10b-5 claim).

[111] *Compare* Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2018), *with* Civil Liabilities on Account of False Registrations Statement, 15 U.S.C.A. § 77k (effective Nov. 3, 1998) (providing antifraud liability only for material omissions or misstatements made in the registration statement which means that a plaintiff cannot bring a §11 claim for any fraudulent activity that arises outside the context of the registration statement and restricts the defendants of a §11 claim to an enumerated list) *and* Civil Liabilities Arising in Connection with Prospectuses and Communication, 15 U.S.C.A. § 77k (2018) (providing antifraud protection to limited class of plaintiffs that only include those who purchased or sold securities against a limited class of defendants) *and* 15 U.S.C.A. § 12(a)(2) (limiting the its scope to misstatement or omissions only in the prospectus or oral communication).

There is no private cause of action explicitly sanctioned in §10(b) or Rule 10b-5.[112] However, the federal courts have recognized an implied private cause of action for securities fraud in Rule 10b-5.[113] Justice Rehnquist referred to the implied private right of action as a "judicial oak which has grown from little more than a legislative acorn."[114] This sentiment reflects the expansive liability that the private cause of action created by Rule 10b-5.

The private right of action under 10b-5 is an important antifraud mechanism. The SEC has limited resources and believes that private rights of actions are a necessary supplement to their own efforts to prevent fraud.[115] The private right of action provides additional deterrence from fraud,[116] so this system could be a helpful mechanism to keep cryptocurrency markets free from fraud. As discussed below, it is more difficult for plaintiffs bringing a private right of action under 10b-5 to show that extraterritorial application is appropriate than for the SEC bringing an enforcement action. This note will discuss both the SEC's ability to bring a 10b-5 action with extraterritorial implications and the same for a private right of action. It is necessary to examine both SEC action and private action because of the importance of the private right of action in supplementing the SEC's ability to police the market.

C. The Courts' Interpretation of the Laws' Extraterritorial Application

The Supreme Court addressed the extraterritorial reach of the United States' securities regulation regime, specifically section 10b and Rule 10b-5, in *Morrison v. National Australia Bank* in 2010.[117] National Australia Bank used HomeSide, a mortgage servicer based in the United States.[118] For years, HomeSide's executives manipulated their financial models to make their mortgage servicing rights seem more valuable.[119] They would submit the fraudulent information to National Australia Bank, which would in turn inflate National Australia Bank's annual reports.[120] National Australia Bank's executives were aware of HomeSide's fraud and that their own statements were inflated as a result, but they nevertheless included the false information in

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[112] *See* Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2018) (omitting an explicit private right of action).

[113] *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1917) ("[I]t was held in 1946 . . . that there was an implied private right of action under [Rule 10b-5].").

[114] *Id.* at 737.

[115] CHOI & PRITCHARD, *supra* note 9.

[116] *Id.*

[117] *See generally* Morrison v. Nat'l Austl. Bank, 561 U.S. 247 (2010).

[118] Boehm, *supra* note 100, at 257.

[119] *Id.*

[120] *Id.*

their own reports.[121] Further, National Australia Bank's executives praised HomeSide's success in public statements.[122] National Australia Bank eventually announced the write-downs relating to HomeSide in 2001, equating to roughly two billion U.S. dollars.[123] As a result, numerous Australian shareholders who had purchased National Australia Bank stock in Australia filed suit in America.[124]

Prior to *Morrison*, the Second Circuit developed two doctrines to determine whether courts had jurisdiction to hear section 10(b) claims: the "conducts" test and the "effects" test.[125] *Morrison* was brought to the Second Circuit Court of Appeals on a "conducts" test theory of subject matter jurisdiction.[126] The conducts test focuses on the underlying activity causing fraud, as opposed to the effects test's approach of focusing on the fraud affecting U.S. investors and markets.[127] The Second Circuit determined that the critical factor of the conduct test is that "significant conduct" in furtherance of the fraud occurred in the United States.[128] Under the conducts test, it did not necessarily matter whether U.S. shareholders or foreign shareholders ultimately endured the loss caused by the fraud.[129] Judge Henry Friendly, when assessing the rationale of the conduct test, reasoned that Congress certainly wanted to avoid the United States "[becoming] used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."[130] In *Morrison*, the Second Circuit used the conducts test to conclude that the U.S.-based conduct was not "at the heart of the fraud" and therefore insufficient to support jurisdiction.[131] While HomeSide ran its operations in the United States, it was National Australia Bank's Australian-based executives' responsibility to report correct information to its shareholders.[132] In the appellate court's view, it was the Australian executives' oversight, not the manipulation of numbers in the United States, that was central to the fraud that harmed investors.[133]

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121 *Id.*
122 *Id.*
123 *Id.*
124 *Id.*
125 *Id.* at 253–54.
126 *Id.* at 257.
127 *Id.* at 254.
128 *Id.* at 255.
129 *Id.*
130 IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975) (addressing whether foreign investors had subject matter jurisdiction under federal securities laws by defrauded foreign individuals where the U.S. was used to manufacture the "fraudulent security devices"), *abrogated by* Morrison v. Nat'l Austl. Bank, 561 U.S. 247 (2010).
131 Boehm, *supra* note 100, at 258.
132 *Id.*
133 *Id.*

These tests were rejected and deemed irrelevant to the extraterritorial application of U.S. securities laws in the cryptocurrency context when the Supreme Court, in *Morrison,* disagreed with Second Circuit's analysis.[134] The Court noted that the "Second Circuit never put forward a textual or even extratextual basis" for the conducts and effects tests.[135] Justice Scalia, writing for the majority, disagreed with the Second Circuit on whether this was a question of subject matter jurisdiction.[136] Instead, he said that §10(b)'s extraterritorial reach was a question of merit.[137] This conclusion flowed from the canon, discussed above, which presumes, absent a clear intent of Congress, a lack of extraterritorial application of a statute.[138]

The *Morrison* holding was that §10(b) only applies to transactions in securities listed on domestic exchanges and domestic transactions in other securities.[139] The holding in *Morrison* is an important step in understanding the development of the law concerning the extraterritorial application of antifraud provisions in U.S. securities laws in response to fraud in cryptocurrency markets. According to the Court, U.S. securities laws focus on the purchase and sale of securities in the U.S., not on the place of deception.[140] The Court essentially replaced the conducts and effects test with a new transactional test.[141] This new test only allows a private right of action to foreign plaintiffs for §10(b) and Rule 10b-5 in two situations.[142] The transactions giving rise to the claim must have either (1) occurred in the United States or (2) involved a security listed on a U.S. exchange.[143]

D. Congress Passes Dodd-Frank

Just days after the Supreme Court issued the *Morrison* opinion,[144] Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[145] Two provisions of Dodd-Frank were in direct response

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[134] Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 247–48 (2010).

[135] *Id.* at 258.

[136] Boehm, supra note 100, at 258.

[137] *Id.*

[138] *Id.*

[139] *Id.* at 259.

[140] *Id.*

[141] Andrew Rocks, *Whoops! The Imminent Reconciliation of U.S. Securities Laws with International Comity After* Morrison v. National Austl. Bank *and the Drafting Error in the Dodd-Frank Act*, 56 VILL. L. REV. 163, 165 (2011).

[142] *Id.*

[143] *Id.*

[144] *Id.* at 188.

[145] Meny Elgadeh, Morrison v. National Austl. Bank*: Life After Dodd-Frank*, 16 FORDHAM J. CORP. & FIN. L. 573, 591–92 (2011).

to the Court's *Morrison* holding.[146] Sections 929p and 929y of Dodd-Frank are the relevant provisions.[147] Dodd-Frank §929p provides extraterritorial jurisdiction of securities laws for violations involving "(1) conduct within the United States that constitutes significant steps in furtherance of the 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."[148] This provision of Dodd-Frank essentially codifies the "conducts" and "effects" tests[149] that the Second Circuit relied upon before the Supreme Court in *Morrison* rejected the tests.[150] Dodd-Frank §929y, however, only authorizes extraterritorial jurisdiction for actions brought "by the Commission or the United States," excluding private actions from the legislative reinstatement of the conducts and effects test in §929p.[151]

These provisions of Dodd-Frank seem to fail at capturing Congress's intent.[152] When Representative Paul Kanjorski, a leader in the drafting of Dodd-Frank, debated the law on the House floor, he asserted that the object of §929p is to rebut the presumption against extraterritorial application.[153] This intent seems unfulfilled when compared to the pre-Dodd-Frank *Morrison* decision.[154] The *Morrison* decision clarified that there is no jurisdictional limit on the extraterritorial application of §10(b).[155] Instead, the restriction on the use of U.S. tribunals stems from the meaning of the statute, which is interpreted with a presumption against extraterritorial application of U.S. law.[156] Section 929p does not directly address the Court's holding,[157] but instead addresses the jurisdiction of U.S. courts in actions brought by the SEC. This does not include whether the securities laws can be applied extraterritorially.[158]

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[146] *Id.* at 592 (explaining that Dodd-Frank addressed numerous financial regulatory concerns, but that two provisions of Dodd-Frank were directly related to the court's *Morrison* holding).

[147] *Id.*

[148] *Id.*

[149] Boehm, *supra* note 100, at 250.

[150] Elgadeh, *supra* note 145, at 592.

[151] *Id.* at 593.

[152] Rocks, *supra* note 141, at 188.

[153] *Id.*

[154] *See* Clearly Gottlieb Steen, *District Judge Rules That Dodd-Frank Allows SEC to Bring Securities Fraud Claims Over Certain Foreign Transactions*, U. OXFORD FAC. L. BUS. L. BLOG (Apr. 20, 2017), https://www.law.ox.ac.uk/business-law-blog/blog/2017/04/district-judge-rules-dodd-frank-allows-sec-bring-securities-fraud (explaining the tension between the *Morrison* decision and the passage of Dodd-Frank).

[155] *Id.*

[156] *Id.*

[157] *Id.*

[158] *Id.*

E. Uncertainty About the Impact of Dodd-Frank on SEC Enforcement Actions

Courts have interpreted the effect of Dodd-Frank §929p's conduct and effects test on the *Morrison* holding issuing the transactional test differently.[159] In *SEC v. Chicago Convention Center*, the Tenth Circuit addressed how Dodd-Frank and the *Morrison* decision interacted with each other.[160] In this case, the SEC alleged that the defendants fraudulently sold millions of dollars' worth of securities to over 250 Chinese nationals investors who hoped to obtain U.S. citizenship through their investment.[161] The investors were allegedly lured into making investments because of the E13-5 Program created under the Immigration and Nationality Act of 1990.[162] This program allowed foreign nationals to qualify for a green card "if the individuals invest $1,000,000 . . . creating or preserving at least 10 jobs for U.S. workers."[163] The SEC brought the suit and sought injunctive relief.[164]

The defendants argued that the *Morrison* decision applied to the case and that it should be dismissed for failure to state a claim.[165] The defendants asserted that under the transactional test put forth in *Morrison*, the SEC is unable to assert a claim against them because the transactions at issue were not domestic transactions.[166] The SEC argued Dodd-Frank revived the conducts and effects test for SEC actions, superseding *Morrison*.[167] The court recognized that the interaction of these two standards create a "complex interpretation issue,"[168] but ultimately did not come to a conclusion on that interpretation issue.[169] Under any of the tests, the SEC stated a claim. The motion to dismiss was denied without reaching the issue of whether Dodd-Frank superseded *Morrison* for claims brought by the SEC.[170]

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[159] *Compare* SEC v. Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 909–917 (N.D. Ill. 2013) (suggesting that Dodd-Frank may not have successfully amended the securities laws), *with* SEC v. Traffic Monsoon, LLC, 245 F. Supp. 3d 1275, 1291–93 (D. Utah 2017) (finding clear indication of congressional intent to codify the conducts and effects test).

[160] *See* SEC v. Chi. Convention Ctr., 961 F. Supp. 2d at 909–17 (explaining how to interpret Dodd-Frank §929p(b) in light of the *Morrison* decision being issued just a few days prior to its passage).

[161] *Id.* at 907.

[162] *Id.*

[163] *Id.*

[164] *Id.* at 908.

[165] SEC v. Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 908 (N.D. Ill. 2013).

[166] *Id.*

[167] *Id.*

[168] *Id.* at 916.

[169] *Id.* at 908.

[170] *See* SEC v. Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 917–918 (N.D. Ill. 2013).

A federal judge did eventually decide how the passage of Dodd-Frank affected the Supreme Court's holding in Morrison for actions brought by the SEC.[171] Judge Parrish's decision in *Traffic Monsoon* was the first federal ruling deciding this issue. The SEC brought an action against Traffic Monsoon, an internet advertising company, in which the SEC alleged that the company was involved in an illegal Ponzi scheme.[172] The SEC alleged that Traffic Monsoon's activity was in violation of §10(b) of the Exchange Act, Rule 10b-5, and §17(a) of the Securities Act. [173]

Traffic Monsoon used Morrison's transactional test to argue that the SEC did not have authority to regulate its transactions.[174] Traffic Monsoon argued that since 90% of customers purchased its securities over the internet and the customers were located outside of the U.S. when they made the purchases, these transactions were primarily foreign and not within the SEC's reach.[175] The SEC argued that Dodd-Frank applied the conducts and effects test to all similar cases.[176] The SEC asserted that the language and history of Dodd-Frank demonstrate that Congress intended to reinstate this test for actions brought by the SEC regarding transnational securities fraud.[177] Under the conduct and effects test, the SEC could bring a claim against Traffic Monsoon because Traffic Monsoon's conduct of creating, marketing, selling, and managing its investment scheme did occur within the U.S.[178]

The court agreed with the SEC and held that Dodd-Frank superseded *Morrison* for actions brought by the SEC. Dodd-Frank sufficiently rebutted the general judicial presumption against extraterritoriality for enforcement actions brought by the SEC under §10(b) of the Exchange Act and §17(a) of the Securities Act.[179]

The court noted that §929p(b) was drafted prior to *Morrison*, at a time in which circuit courts widely applied the conduct and effects test.[180] In a context where the Supreme Court had not yet issued its *Morrison* decision, the court reasoned that Dodd-Frank simply codified the already-prevailing standard.[181] The last meeting to reconcile the House and Senate bills occurred on the day the Supreme Court issued *Morrison*.[182] As such, the court stated that "[i]t strains credulity" to assume that legislators considered the Court's decision

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171 Steen, *supra* note 154.
172 *Id.*
173 *Id.*
174 *Id.*
175 *Id.*
176 *Id.*
177 *Id.*
178 *Id.*
179 *Id.*
180 *Id.*
181 *Id.*
182 *Id.*

when finalizing Dodd-Frank.[183] Judge Parrish concluded, "[t]o conform Section 929P(b) to the *Morrison* opinion at the last minute would be like requiring a steaming battleship to turn on a dime to retrieve a lifejacket that fell overboard," and "[t]hus the court does not presume that Congress intended Section 929P(b) to be a nullity."[184]

The court in *Traffic Monsoon* noted that legislators who worked on the bill explicitly expressed their understanding that Dodd-Frank codified the conduct and effects test.[185] Further, the court reasoned that the assumption that Congress intended the amendment "to be mere surplusage, with no discernable effect, flies in the face of reason" because §929P(b) would be a nullity if Morrison applied to SEC actions under §§10(b) and 17(a).[186] The court explained, "[i]t would be pointless to clarify that district courts had jurisdiction to hear Section 10(b) and 17(a) claims based on certain extraterritorial transactions unless Congress also intended that these statutes be applied extraterritorially."[187]

Though the effect of Dodd-Frank on the *Morrison* decision in terms of the extraterritoriality of §10(b) in SEC enforcement actions is uncertain,[188] this Note follows the *Traffic Monsoon* interpretation of the issue. This leads to the assumption that Dodd-Frank supersedes the *Morrison* decision for SEC enforcement actions.[189] Accordingly, the SEC can use U.S. tribunals to bring actions against foreign transactions when those transactions meet the conducts and effects test.[190]

The conducts and effects test under Dodd-Frank gives the SEC a broader ability to bring enforcement actions against unregistered ICOs abroad than an individual has under *Morrison*'s transactional test. The language of Dodd-Frank §929p allows the SEC to bring an action against foreign conduct so long as the transactions meet either the conducts test or the effects test.[191] The conducts test focuses "on the nature of [the] conduct within the United States as it relates to carrying out the alleged fraudulent scheme."[192] The rationale

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[183] *Id.*

[184] *Id.*

[185] *Id.*

[186] *Id.*

[187] *Id.*

[188] *Compare* SEC v. Chi. Convention Ctr., LLC*,* 961 F.Supp.2d 905, 909–16 (N.D. Ill. 2013) (suggesting that Dodd-Frank may not have successfully amended the securities laws), *with* SEC v. Traffic Monsoon, LLC, 245 F.Supp.3d 1275, 1294 (D. Utah 2017) (finding clear indication of congressional intent to codify the conducts and effects test).

[189] Traffic Monsoon, 245 F. Supp. 3d at 1294.

[190] *See id.*

[191] *Id.* at 1292.

[192] 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 11 (2012), https://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.p

behind this test is to ensure that the United States does not become a base for fraudulent activity, harming foreign investors.[193]

There is a broad range of what level of domestic conduct is sufficient to satisfy the conducts test. Some circuits require that the domestic conduct in itself constitutes a violation of U.S. securities laws.[194] Other courts, however, require only some activity that is significant to the furtherance of the fraudulent scheme within the United States in order to satisfy the conducts test.[195] These two approaches represent extreme ends of the spectrum,[196] but many courts fall in between these two approaches.[197] These courts generally find that when some activity within the United States was significant to the scheme, the conducts test is satisfied.[198]

Even if the conducts test is not satisfied, the SEC can still bring an action if it satisfies the effects test. The effects test is satisfied when conduct occurring in foreign countries "cause[s] foreseeable and substantial harm to interests in the United States."[199] The rationale behind the effects test comes from the principle that acts done outside of a jurisdiction but nevertheless intend to produce, threaten to produce, or foreseeably do produce harmful effects within that jurisdiction, justify punishment of the offender by that jurisdiction as if the actor had performed the activity within its borders.[200] Under the

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df (citing Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983)) [hereinafter SEC 10b-5 Study].

193 *Id.* (citing Europe & Overseas Commodity Trades, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998)).

194 *See* Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 31 (D.C. Cir. 1987) ("[J]urisdiction will lie in American courts where the domestic conduct comprises all the elements of a defendant's conduct necessary to establish [a violation of the antifraud provisions].").

195 *See, e.g.*, Grunenthal GmbH v. Hotz, 712 F.2d 421, 425 (9th Cir. 1983); Cont'l Grain (Austl.) Pty. Ltd. v. Pac. Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir. 1979); SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977).

196 SEC 10b-5 Study, *supra* note 192, at 11.

197 *Id.*

198 *Id.*; *see, e.g.*, Kauthar SDN BHD v. Sternberg, 149 F.3d 657, 667 (finding that when conduct "forms a substantial part of the alleged fraud and is material to its success," the conducts test is satisfied); Robinson v. TCI/US W. Commc'n Inc., 117 F.3d 900, 905–06 n.10 (5th Cir. 1997) (domestic conduct must be "material" and "substantial"); Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983) (domestic conduct must be "material" and "substantial").

199 SEC 10b-5 Study, *supra* note 192, at 12 (citing Mak v. Wocom Commodities Ltd., 112 F.3d 287, 289 (7th Cir. 1997) (quoting Tamari v. Bache & Co. (Lebanon) S.A.L., 730 F.2d 1103, 1108 (7th Cir. 1984)); *see also* Europe & Overseas Commodity Trades, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998); Interbrew S.A. v. Edperbrascan Corp., 23 F. Supp. 2d 425, 430 (S.D.N.Y. 1998)).

200 SEC 10b-5 Study, *supra* note 192 (citing Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968)) (presuming that because it focused on domestic injuries for which the United States has long been viewed as having a strong sovereign interest in redressing, the effects test appears to have been relatively uncontroversial); *see generally* Strassheim v. Daily, 221 U.S. 280, 285 (1911) ("Acts done outside a jurisdiction, but intended to produce

effects test, the SEC could bring an action when American investors, securities traded on a U.S. exchange or issued by a U.S. entity, or U.S. domestic markets are harmed.[201]

It is easier for the SEC to bring enforcement actions by satisfying the conducts and effects test rather than *Morrison*'s transactional test. In fact, the SEC has already halted a foreign ICO and brought a Rule 10b-5 claim against the company with no issues surrounding extraterritoriality. However, the private right of action is an important enforcement tool of U.S. securities regulation.[202] The SEC has limited resources to bring their enforcement actions. The next section will therefore examine the private cause of action for extraterritorial Rule 10b-5 claims relating to cryptocurrency transactions.

IV. PRIVATE CAUSES OF ACTION

A. Morrison *Transactional Test in Private Causes of Action*

The *Morrison* transactional test still applies to private causes of action when litigants claim a violation of §10(b). The Dodd-Frank §929p codification of the conducts and effects test only applies to actions brought by the SEC or Department of Justice.[203] In order to determine how a foreign investor can bring a private action for fraudulent cryptocurrency actions, it is important to look to how the test has been applied in U.S. courts.

The transactional test put forth in *Morrison* has two prongs, only one of which must be met to create jurisdiction.[204] The fraudulent security must be either (i) connected with the purchase or sale of a security listed on an American stock exchange, or (ii) purchased in the United States.[205] It seems unlikely that ICOs will satisfy the first prong of the transactional test because they are not listed on formal exchange platforms such as the New York Stock Exchange. Therefore, this Note will focus on the second prong of the

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and producing detrimental effects within it, justify a State in punishing the cause of the harm as if he had been present at the effect . . . .").

[201] SEC 10b-5 Study, *supra* note 192, at 12–13.

[202] *See* U.S. SEC. & EXCH. COMM'N, LITIGATION RELEASE NO. 24170, SECURITIES AND EXCHANGE COMMISSION V. PLEXCORPS, ET AL. (2018), https://www.sec.gov/litigation/litreleases/2018/lr24170.htm (announcing the SEC's enforcement action against Dominic Lacroix, a Quebec securities law violator).

[203] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–203 §929p 124 Stat. 1865 (2010).

[204] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010).

[205] *See* SEC 10b-5 Study, *supra* note 192 (noting that the court in Morrison instructed that under the transactional test, "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.").

transactional test: that the security must have been purchased within the United States.[206]

Many scholars recognize that determining what constitutes a domestic transaction under the second prong of *Morrison*'s transactional test is one of the most difficult issues the courts dealt with in the years following the *Morrison* decision.[207] The difficulty stemmed from the Supreme Court's silence as to when a transaction occurs "in the United States" when the security was not listed on a U.S. exchange.[208] Courts set forth competing approaches to determine when an off-exchange transaction occurs in the United States.[209]

Some courts presupposed that securities transactions can take place across multiple jurisdictions.[210] Under this approach, courts examine the entire transaction and "determine if any of the critical steps occurred" in the United States.[211] Other courts examined the transaction closely to determine precisely when, in the course of the purchase or sale, "the parties incurred 'irrevocable liability' to complete the transaction."[212] If the moment of irrevocable liability occurred in the United States, then the investor could bring a private cause of action under §10(b).[213] If the moment of irrevocable liability occurred outside of the United States, a §10(b) private cause of action would not be available to investors.[214]

B. Tezos *Decision*

The issue of extraterritorial application of securities laws on cryptocurrency transactions came up in August 2018, when a U.S. District Court heard a class action case in which a group of investors attempted "to hold a cryptocurrency enterprise liable for violations of federal securities law."[215] The

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[206] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010).

[207] SEC 10b-5 Study, *supra* note 192, at 33.

[208] *Id.*

[209] *Id.* at 34.

[210] *See In re* Nat'l Century Fin. Enters. ("Nat'l Century"), 755 F. Supp. 2d 857, 879–88 (S.D. Ohio 2010) (relying on *Morrison*'s transactional test to construe the extraterritorial reach of the Ohio Securities Act).

[211] *Id.*

[212] *See, e.g.*, Basis Yield Alpha Fund (Matter) v. Goldman Sachs, 798 F. Supp. 2d 533, 537 (citing SEC v. Goldman Sachs, 790 F.Supp.2d 147 (S.D.N.Y. 2011).

[213] U.S. SEC. AND 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: AS REQUIRED BY SECTION 929Y OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2012) .

[214] *Id.*

[215] *In re* Tezos Sec. Litig., No. 17-cv-06779-RS, 2018 WL 4293341, at *1 (N.D. Cal. 2018) (deciding issues of extraterritorial application of United States' securities regulation of a cryptocurrency enterprise).

complaint was brought against a number of defendants.[216] A few located in California were Arthur and Kathleen Breitman and their company, Dynamic Ledger solutions.[217] The Tezos Foundation, a nonprofit established by the Breitmans based in Switzerland, was used to oversee the ICO at issue and was another defendant.[218] The final defendant was Bitcoin Suisse, a foreign firm specializing in the crypto-financial sector which provided intermediary services to some ICO contributors.[219]

Unsurprisingly, this issue of extraterritoriality did not apply to the defendants located in California, since they clearly subjected themselves to United States' laws by being physically present within its borders.[220] The court first addressed Bitcoin Suisse's role as a defendant.[221] The court determined that it did not have specific jurisdiction over Bitcoin Suisse.[222] The intermediary did not provide services for the Tezos ICO to any U.S. investor.[223] This undermines the plaintiffs' ability to prove that the defendant committed an intentional act expressly aimed at the forum state, causing harm which the defendant knew was likely to be suffered in the forum state.[224] Accordingly, the claim against Bitcoin Suisse was dismissed.[225]

The court next addressed its jurisdictional reach over the Tezos Foundation.[226] Tezos's website was freely accessible to U.S. citizens, was hosted on an Arizona server, and was highly interactive.[227] All of these factors were sufficient to establish personal jurisdiction under the relevant standard.[228] As

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[216] Tod Sawicki & Christina Bortz, *Cryptocurrency Securities Class Action Suits: Paving the Path for U.S. Jurisdiction*, ALSTON & BIRD SEC. LITIG. ADVISORY (Aug. 29, 2018), https://www.alston.com/-/media/files/insights/publications/2018/08/cryptocurrency-securities-class-action-suits.pdf.

[217] *Id.*

[218] *Id.*

[219] *Id.*

[220] *In re* Tezos Sec. Litig., No. 17-cv-06779-RS, 2018 WL 4293341, at *4–*6 (N.D. Cal. 2018) (ignoring the issue of personal jurisdiction regarding the Breitmans and Dynamic Solutions, the California based defendants).

[221] *Id.* at *5.

[222] *Id.*

[223] *Id.*

[224] *Id.* The court applied the three-part standard from *Calder v. Jones* to determine that the court did not have specific jurisdiction over Bitcoin Suisse. 465 U.S. 783 (1984). The court explained that this standard "requires that the defendant allegedly have (1) committed an intentional act, (2) expressly aimed at the forum state, (3) causing harm that the defendant knows is likely to be suffered in the forum state." Schwarzenegger v. Fred Martin Motor Co., 374 F.3d 797, 803 (9th Cir. 2004) (citing Calder v. Jones, 465 U.S. 783 (1984)).

[225] *In re* Tezos Sec. Litig., No. 17-cv-06779-RS, 2018 WL 4293341, at *5 (N.D. Cal. 2018).

[226] *Id.* at *6.

[227] Sawicki & Bortz, *supra* note 216.

[228] *Id.*; *see also In re* Tezos Sec. Litig., 2018 WL 4293341, at *6 (noting that these contacts to the United States are sufficient to establish personal jurisdiction because the

such, the claim was not dismissed and the court was able to address the issue of extraterritorial application of U.S. securities laws as applied to an ICO.

Since this ICO was not listed on a domestic exchange, the second prong of *Morrison* is the relevant inquiry. The defendants argued that the second prong of *Morrison* requires that the transaction itself be domestic.[229] The defendants argued that the transactions took place outside of the United States and it would therefore be inappropriate to apply U.S. securities laws to the transactions.[230] The Tezos Foundation argued that their transactions occurred in Alderney, a British territory, because that was "the legal site of all ICO transactions" according to the forum selection clause in the contracts.[231] The defendants reasoned that the "contractual situs" of the transaction was foreign, so the purchase and sale occurred outside of the U.S.[232] The defendants also argued that the location of their website was not as important as the location of the foundation's "contribution software."[233]

The court rejected Tezos's argument and found that the relevant inquiry is where the actual situs of buying an unregistered security online and recorded on the blockchain took place.[234] In Tezos's case, the actual situs occured within the United States.[235] The defendant used an interactive website that was hosted on a server in Arizona and run primarily by someone in California.[236] The plaintiff learned about the ICO from marketing almost exclusively targeting United States residents.[237] Lastly, the plaintiff's contribution to the ICO became irrevocable only once it was validated by a network of "nodes" which were clustered more densely in the United States than anywhere else in the world.[238] Taking all of these factors into account, the court determined this was a domestic transaction and thus satisfied the second prong of *Morrison*.[239]

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plaintiffs sufficiently alleged facts to show that Tezos's activity was "something more" than merely posting to a website).

[229] Sawicki & Bortz, *supra* note 216, at 2.

[230] *In re* Tezos Sec. Litig., 2018 WL 4293341, at *8 (stating that according to the "bedrock principle" against extraterritoriality articulated in *Morrison* and the Exchange Act only regulates domestic transactions).

[231] *Id.* at *2 (defining "Contribution Terms" as a clause within the Tezos Foundation's forum selection clause).

[232] Sawicki & Bortz, *supra* note 216.

[233] *Id.* (citing *In re* Tezos Sec. Litig., 2018 WL 4293341, at *8).

[234] *Id.*

[235] *Id.*

[236] *In re* Tezos Sec. Litig., 2018 WL 4293341, at *8.

[237] *Id.*

[238] *Id.*

[239] *Id.*

V. ANALYSIS

If the Supreme Court were to hear an appeal of *Tezos*, they would likely affirm and hold that *Morrison* was correctly applied in the cryptocurrency context. The test adopted by the court in *Morrison* is relatively simple. Private rights of action for Rule 10b-5 have extraterritorial application only when the use of a manipulative or deceptive device or contrivance in connection with the purchase or sale with either a security listed on an American stock exchange or any other security in the United States.[240]

Cryptocurrencies generally are not traded on U.S. exchanges,[241] but the New York Stock Exchange has announced that it will become a platform for cryptocurrencies.[242] The exchange will create a company called Bakkt, which will manage investors' cryptocurrencies,[243] starting with Bitcoin exclusively.[244] Since Bitcoin is relatively established for a form of cryptocurrency,[245] there is less of a fear of fraud relating to its trading. This means that for purposes of 10b-5 claims, it is unlikely that investors will claim extraterritorial application based on the "purchase or sale of a security listed on an American stock exchange" prong of the *Morrison* test.

Eliminating this prong means that most claims will be brought by alleging that the purchase or sale of the security at issue occurred in the United States. This is what the *Tezos* court held.[246] As mentioned above, the Tezos court determined that this fraudulent ICO did occur "in the United States" for various reasons.[247] The "actual situs" of purchasing the unregistered securities occurred within the United States.[248] The website used to sell the unregistered securities was hosted on a server within the United States, the website was controlled by a U.S. resident, and the transaction become irrevocable when it was validated by a network of nodes that were clustered most densely in the United States.[249] The court determined all of these factors taken together lead

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[240] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 273 (2010).

[241] *See* Dani Deahl, *New York Stock Exchange Owner is Launching a Bitcoin Exchange*, VERGE (Aug. 3, 2018), https://www.theverge.com/2018/8/3/17648830/nyse-new-york-stock-exchange-owner-bitcoin-launch-cryptocurrency (explaining that the NYSE providing a trading medium for cryptocurrency is a new development).

[242] *Id.*

[243] *Id.*

[244] *Id.*

[245] *See* Tal Yellin, Dominic Aratari & Jose Pagliery, *What is Bitcoin*, CNN MONEY (Aug. 8, 2018), https://money.cnn.com/infographic/technology/what-is-bitcoin/index.html (stating that Bitcoin was established in 2009, meaning it is now eleven years old).

[246] *See generally In re* Tezos Sec. Litig., No. 17-cv-06779-RS, 2018 WL 4293341 (N.D. Cal. 2018).

[247] *Id.*

[248] *Id.*

[249] *Id.*

to the conclusion that the transaction occurred in the United States.[250] The most important factor was arguably the dense cluster of nodes within the United States.[251]

Is this holding consistent with how the second prong of *Morrison* has been interpreted outside the context of cryptocurrencies? Courts typically use two approaches to interpret the second prong of *Morrison*: one is to examine whether any of the critical steps of the transaction occurred domestically and the other is to examine where the parties incurred "irrevocable liability" that completed the transaction.[252] The *Tezos* decision is consistent with both approaches.

The "critical step" approach applies to the *Tezos* decision because the court recognized that a contributing factor to the domestic treatment of the transaction was the fact that the cluster of nodes validating the transaction were most densely present in the United States.[253] These nodes are a critical step in the entire transaction that did occur domestically. Without the nodes, the transaction could not have taken place. Even if the nodes did not satisfy the "critical step" test, the domestic website would satisfy the critical step approach as well. The website was the sole means through which investors were able to purchase securities, and therefore critical to the process as a whole.[254]

The "irrevocable liability" approach is also consistent with the *Tezos* decision because the moment the transaction became final and the purchaser incurred irrevocable liability was when the network of nodes validated the transaction.[255] The nodes were most densely clustered in the United States,[256] which means the irrevocable liability must have occurred in the United States.

Some may argue that the *Tezos* decision was decided wrongly because it applied *Morrison*'s transaction test incorrectly. One argument against the *Tezos* opinion is that the cluster of nodes was not enough to consider the transaction "in the United States."[257] This counterargument has some validity—the *Tezos* transaction did have other critical steps that occurred outside of the United States, such as the legal site of the seller in Switzerland.[258] The *Tezos*

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[250] *Id.*

[251] *See* David Felsenthal et. al., *Tokens and the Extraterritorial Reach of US Securities Law*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Oct. 24, 2018), https://corpgov.law.harvard.edu/2018/10/24/tokens-and-the-extraterritorial-reach-of-us-securities-laws/ ("While the location of validation nodes is only one factor discussed by the court, it could have far reaching implications . . . .").

[252] *See* SEC 10b-5 Study, *supra* note 192, at 34.

[253] *In re* Tezos Sec. Litig., No. 17-cv-06779-RS, 2018 WL 4293341 (N.D. Cal. 2018).

[254] *Id.*

[255] *Id.*

[256] *Id.*

[257] *Id.* (discussing the defendant's claim that "critical aspects of the sale occurred outside of the United States.").

[258] *Id.* at *8.

defendant also made the convincing argument of the "'bedrock principle' against extraterritorial application of U.S. law."[259] Nevertheless, the majority rightfully rejected these arguments.[260] While it is true that there is a bedrock principle against extraterritorial application of U.S. laws, the SEC also has a bedrock principle of protecting U.S. investors.[261] The *Tezos* defendants threatened the protection of U.S. investors by targeting U.S. residents in the promotion of their ICO.[262]

Since the *Tezos* decision is consistent with the past interpretation of the *Morrison* decision, the court's interpretation of extraterritorial application of §10(b) and Rule 10b-5 as applied to cryptocurrency has a sufficient legal basis. In future cases similar to *Tezos*, courts will have to look at numerous factors to determine if the transaction occurred in the United States. The *Tezos* court examined the location of the server which hosted the securities sales website, the residency of the website controller, and the means by which the transaction becomes irrevocable.[263] Courts will look to this non-exclusive list of factors to find evidence about where the actual situs of buying unregistered securities occurred.

Based on the *Tezos* decision, it is possible that foreign investors will be able to bring Rule 10b-5 claims in the United States for certain ICOs as long as the plaintiff can show that the actual situs of the transaction occurred in the United States. If the ICO is truly global in nature and not intentionally avoiding the United States, the investor will likely be able to carry the burden of showing the transaction was in the United States. If the sales website has substantial ties to the United States, like the website in *Tezos*, the plaintiffs will be able to find relief in U.S. courts. However, the Court likely did not contemplate that the transactional test would be applied to the cryptocurrency market one day when it made the *Morrison* decision in 2010. The growing cryptocurrency market is much different than the traditional securities markets that our case law contemplates. The SEC or Congress should provide guidance on how to regulate the cryptocurrency market with securities laws instead of our judiciary applying tests created for different contexts.

VI. CONCLUSION

Since the SEC has declared that some ICOs are within the purview of federal securities regulation, there has been a reexamination of various doctrines and their applicability to the emerging cryptocurrency market. The doctrine

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[259] *In re* Tezos Sec. Litig., No. 17-cv-06779-RS, 2018 WL 4293341, at *8 (N.D. Cal. 2018).

[260] *Id.*

[261] SEC 10b-5 Study, *supra* note 192, at 64.

[262] *In re* Tezos Sec. Litig., 2018 WL 4293341, at *8.

[263] *Id.*

of extraterritoriality has quickly become an unresolved issue within the federal regulation of cryptocurrency through securities laws.

The Supreme Court decided *Morrison* in 2010, which addressed extraterritorial application of Rule 10b-5 generally. Just days later, Congress superseded the Court's *Morrison* decision for SEC enforcement actions by passing Dodd-Frank. As such, the SEC can bring actions under the conducts and effects test, including actions against foreign cryptocurrency fraud if there is sufficient conduct within the United States. The SEC has already been able to bring enforcement actions against foreign fraudulent ICOs under these tests.

However, the private right of action is also an important enforcement tool for U.S. securities regulation. The harsher transactional test adopted in *Morrison* still applies to the private cause of action. An individual can bring a 10b-5 claim against a foreign issuer if the security was either traded on a U.S. exchange or the transaction occurred in the United States. Cryptocurrencies are not traded on any U.S. exchange yet, so cryptocurrency transactions will have to be "in the United States" for an individual to bring a Rule 10b-5 claim.

In August, a U.S. District Court applied the *Morrison* "in the United States" test to a cryptocurrency transaction.[264] That court found that the transaction did occur in the United States because various factors evidenced that the actual situs of the transaction occurred in the United States.[265] These factors included the location of the website on which transactions occurred on, the location of the person controlling the website, and the location of nodes that finalized the transaction.[266] Based on previous interpretations of *Morrison* outside of the cryptocurrency context, the *Tezos* decision would likely be upheld if it were appealed to the Supreme Court.

However, in the wake of a brand-new form of currency, it is time for the SEC or Congress to formulate rules and regulations specifically addressing the complex issues arising in the emerging cryptocurrency market.

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264 *See generally id.*
265 *Id.*
266 *Id.*