

Foreign Initial Coin Offering Issuers Beware: The Securities and Exchange Commission is Watching

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Foreign Initial Coin Offering Issuers Beware: The Securities and Exchange Commission is Watching

Julianna Debler[†]

Introduction	246
I. Background	249
A. What Is a Cryptocurrency?	249
B. What is an Initial Coin Offering (“ICO”)?	251
1. <i>Startups Use ICOs to Fundraise</i>	251
2. <i>ICOs are Inherently Risky</i>	252
3. <i>The U.S. Regulators Are Increasing Regulatory Efforts to Target Cross-Border ICOs</i>	252
II. The SEC Has Congressional Authority to Regulate Most ICOs	254
A. What is a Security?	255
B. Most ICOs are Securities Because They Are Investment Contracts Under the <i>Howey Test</i>	255
1. <i>SEC v. Shavers: Cryptocurrencies are an “Investment of Money”</i>	256
2. <i>SEC v. SG Ltd.: Investors in a Virtual Entity Create a “Common Enterprise”</i>	257
3. <i>In re Munchee Inc.: ICOs Provide a “Reasonable Expectation of Profits”</i>	258
4. <i>The DAO Investigation: ICOs Promise Returns That are “Derived from the Managerial Efforts of Others”</i> .	259
III. The SEC Has Considerable Extraterritorial Authority to Regulate ICOs	260
A. The SEC’s Power to Enforce the Securities Registration Requirements of Section 5 of the Securities Act Has Considerable Force Outside the U.S.	261
B. The SEC Has Broad Congressional Authority to Police Fraudulent Cross-Border Securities Transactions Under Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act	262

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1. Morrison v. Australian National Bank: <i>The U.S. Securities Laws Apply Only to “Domestic Transactions”</i>	263
2. SEC v. Traffic Monsoon, LLC: <i>The Dodd Frank Act Restores the “Conduct and Effects” Test with Respect to Extraterritorial Transactions</i>	263
3. SEC v. PlexCorps: <i>There is Inherent Difficulty in Applying SEC v. Traffic Monsoon to a Cross-Border ICO</i>	265
4. <i>The SEC’s International Enforcement Assistance Program Under the Exchange Act</i>	267
5. <i>The SEC’s International Information-Sharing Arrangements Will Enable it to Regulate Cross-Border ICOs</i>	268
6. <i>The SEC’s Strong Relationships with Foreign Criminal Authorities Will Facilitate Its International Securities Enforcement Efforts</i>	270
Conclusion	270

Introduction

Cryptocurrencies have become an international business. In early 2013, the value of the global cryptocurrency market was less than \$2 billion.¹ As of May 2018, it has transformed into a \$400 billion digital payment ecosystem.² Nearly \$15 billion in cryptocurrency transactions are executed daily around the world,³ and that number is rising daily. This increase has largely been driven by the recent rise in initial coin offerings (“ICOs”),⁴ a fundraiser in which a promoter sells a unique digital “coin” or “token” called a “cryptocurrency” to investors in exchange for money or established cryptocurrencies, such as Bitcoin or Ether.⁵ ICOs have become popular among startups as a means to quickly raise capital by circumventing the highly-regulated capital-raising process venture capitalists and

1. *Cryptocurrency Market Capitalizations; Historical Snapshot - April 28, 2013*, COINMARKETCAP <https://coinmarketcap.com/historical/20130428/> (reporting that on April 28, 2013, the total market capitalization for cryptocurrencies was approximately \$1.6 billion U.S. dollars) [<https://perma.cc/FE6A-YFT8>].

2. *Cryptocurrency Market Capitalizations*, COINMARKETCAP, <https://coinmarketcap.com> [<https://perma.cc/A4HR-MDSR>].

3. *Id.*

4. See *CoinDesk ICO Tracker*, COINDESK <https://www.coindesk.com/ico-tracker/> (last updated Jan. 1, 2018) (disclosing that there were 343 ICOs in 2017, up from 256 ICOs in 2016) []; see also *Investor Bulletin: Initial Coin Offerings*, SEC (July 25, 2017), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings (warning investors about the recent increase in ICOs and their potential for fraud) [<https://perma.cc/PM86-SJRB>]; Daniel N. Budofsky et al., *Initial Coin Offerings (ICOs): The Current State of Play*, PILLSBURY (Nov. 3, 2017), <https://www.pillsburylaw.com/en/news-and-insights/icos-current-state.html> (explaining how the global market capitalization of cryptocurrencies surged in 2017 as a result of the rapid rise in the number of ICOs and the value of popular cryptocurrencies like Bitcoin and Ether) [<https://perma.cc/T9YA-ASJ4>].

5. See *Investor Bulletin: Initial Coin Offerings*, *supra* note 4.

underwriters follow in initial public offerings.⁶

The growth of this generally unregulated fundraising process, however, has simultaneously led to serious concerns regarding its legality, accountability, and control.⁷ In July 2017, the U.S. Securities and Exchange Commission (the “SEC”) announced for the first time that it would begin regulating the offer and sale of cryptocurrencies in connection with ICOs.⁸ The SEC cautioned that these “virtual coins or tokens may be securities,”⁹ and it is on “high alert” for ICOs that violate the United States securities laws.¹⁰

Since the SEC’s initial warning and May 2018, the SEC initiated six lawsuits and administrative enforcement proceedings in connection with ICOs and similar cryptocurrency offerings¹¹ for violations of the registration requirements of sections 5(a) and 5(c) of the Securities Act of 1933 (the “Securities Act”)¹² and the antifraud provisions of section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”)¹³ and Rule 10b-5 thereunder.¹⁴ These lawsuits include a Canadian ICO that raised \$15 million from investors worldwide¹⁵ and a Texas ICO that raised over \$600 million from investors around the globe to fund what it claimed to be the world’s first “decentralized bank.”¹⁶ Notably, the judges in these cases have not yet decided whether the ICOs are “securities” and, therefore, subject to the federal securities laws.¹⁷

6. See Budofsky et al., *supra* note 4; see also *ICOs (Initial Coin Offerings): The New Rage of Crypto-market*, CRYPTOTALKS (Dec. 13, 2017), www.cryptotalks.in/en/icos-initial-coin-offerings-the-new-rage-of-crypto-market (asserting that startups are increasingly utilizing ICOs instead of traditional fund-raising strategies such as venture capitalism and IPOs because ICOs have more favorable tax, regulatory, and liquidity consequences and have been generally unregulated) [<https://perma.cc/4WYH-CEV2>].

7. Divya Joshi, *These are the Trends Affecting the Cryptocurrency Market in 2017*, BUS. INSIDER (Sept. 19, 2017), <http://www.businessinsider.com/cryptocurrency-market-coin-trends-cap-value-2017-9> [<https://perma.cc/UF9K-VLLM>].

8. *SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities*, SEC (July 25, 2017), <https://www.sec.gov/news/press-release/2017-131> [<https://perma.cc/VZ5Y-FSP5>].

9. *Id.* (emphasis added).

10. *Opening Remarks at the Securities Regulation Institute*, SEC (Jan. 22, 2018), <https://www.sec.gov/news/speech/speech-clayton-012218> [<https://perma.cc/YN2E-FJ29>].

11. See Jason P. Gottlieb, *MoCo Cryptocurrency Litigation Tracker*, MORRISON COHEN 1–20, 6–8 <https://www.morrisoncohen.com/siteFiles/files/MoCo%20Cryptocurrency%20Litigation%20Tracker%201-30-18.pdf> (updated as of May 14, 2018) [<https://perma.cc/3T5U-D48C>].

12. 15 U.S.C. §§ 77e(a), 77e(c) (2012).

13. *Id.* § 78j(b) (2010).

14. 17 C.F.R. § 240.10b-5 (2017).

15. *SEC v. PlexCorps*, No. 1:17-cv-07007-CBA-RML, 2017 WL 5988934 (E.D.N.Y. Dec. 1, 2017).

16. *SEC v. REcoin Grp. Found., LLC*, No. 1:17-cv-05725, 2017 WL 4329876 (E.D.N.Y. Sept. 29, 2017).

17. See Mem. and Order at 3, *REcoin Grp.*, No. 1:17-cv-05725 (Jan. 31, 2018), ECF No. 24 (withholding decision as to whether the underlying ICO is a “security” in the SEC enforcement lawsuit pending the resolution of the related criminal action but permitting the SEC to submit briefs to help the criminal court consider the question); Min. Order and Min. Entry, *PlexCorps*, No. 1:17-cv-07007-CBA-RML (Jan. 9, 2018) (setting

Although the SEC is moving swiftly to prosecute fraudulent and unregistered ICOs, many securities lawyers argue that it does not have the congressional authority to do so because ICOs are not “securities.”¹⁸ As of May 14, 2018, five federal SEC enforcement lawsuits involving ICOs and similar cryptocurrency offerings are challenging this precise issue.¹⁹ One federal district court judge in Brooklyn, New York is expected to be the first to rule on this important question by the summer of 2018.²⁰ Ultimately, this judge’s ruling will turn on the critical distinction of whether ICOs are “investment contracts” under the Supreme Court’s investment contracts test promulgated in *SEC v. W.J. Howey Co.*²¹ If ICOs are not investment contracts, then the SEC may lack the jurisdiction to regulate ICOs because they are not securities.²²

Accordingly, because no federal court as of the date of this Note has ruled on whether ICOs are securities and, if they are, how the U.S. securities laws should apply to cross-border ICOs, two key issues arise: (1) whether the SEC has the congressional authority to regulate ICOs and, if it does, (2) whether that regulatory authority also extends to “foreign” ICOs that involve either non-domestic issuers and domestic investors or domes-

oral arguments for decision of whether the ICO was a “security” for June 19, 2018); see also Patricia Hurtado, *A Major Court Case Will Decide Whether Bitcoin Can Be Regulated Like Stocks and Bonds*, TIME (Jan. 29, 2018), time.com/money/5123510/are-cryptocurrencies-and-icos-scams-the-government-will-soon-decide/ (explaining that no federal court has yet decided whether ICOs are “securities”) [<https://perma.cc/PQ8A-P2Z9>].

18. See Hurtado, *supra* note 17.

19. See *SEC v. Sharma*, No. 1:18-cv-02909, 2018 WL 1603904 (S.D.N.Y. Apr. 2, 2018) (SEC court action against two Florida co-founders of a Florida-based financial services start-up for defrauding investors throughout the world in an ICO that raised \$32 million); *SEC v. Montroll*, No. 1:18-cv-01582, 2018 WL 1001076 (S.D.N.Y. Feb. 21, 2018) (SEC court action against an unregistered Texas-based Bitcoin-denominated securities exchange and its Texas operator for defrauding exchange users by misappropriating their bitcoins and for failing to disclose a cyberattack that resulted in the theft of more than 6,000 bitcoins and selling unregistered securities that purported to be investments in the exchange); *SEC v. AriseBank*, No. 3:18-cv-00186-M, 2018 WL 623772 (N.D. Tex. Jan. 25, 2018) (SEC court action against a Texas-based cryptocurrency bank and its Texas operators for defrauding investors throughout the world and selling unregistered securities in an ICO that raised \$600 million on the claim that it was the world’s first “decentralized” bank); *PlexCorps*, 2017 WL 5988934 (SEC court action against a “recidivist securities law violator” in Canada and his Canadian partner for misappropriating \$15 million in investor funds raised from investors around the world through a fraudulent and unregistered ICO); *REcoin Grp.*, 2017 WL 4329876 (SEC court action against a New York businessman and two U.S.-based companies for defrauding investors throughout the world of \$300,000 in a pair of ICOs purportedly backed by investments in real estate and diamonds).

20. See Min. Order and Min. Entry, *PlexCorps*, No. 1:17-cv-07007-CBA-RML (Jan. 9, 2018).

21. 328 U.S. 293, 301 (1946) (“The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.”).

22. See *id.* But cf. Order Granting in Part and Den. in Part Defs.’ Mot. for R., *SEC v. Shavers*, No. 4:13-CV-416, 2014 WL 12622292, at *8, n. 6 (E.D. Tex. Aug. 26, 2014) (declining to address the SEC’s argument that the Bitcoin-denominated investments were also “notes” under the U.S. securities laws after having determined that they were “investment contracts” under *Howey*, leaving the question open for other courts).

tic issuers and non-domestic investors. This Note seeks to fill that judicial void.

To facilitate the understanding of ICOs, Section I briefly describes the function of the blockchain, the distributed ledger technology underpinning Bitcoin and other cryptocurrencies. It also describes the application of cryptocurrencies in ICOs.

Section II demonstrates that most ICOs meet the definition of a security under *Howey*²³ and, therefore, can be regulated by the SEC like stock or bond offerings.

Section III analyzes the legality of the SEC's current approach to the regulation of cross-border ICO transactions in light of the longstanding principle that the U.S. securities laws do not have extraterritorial application.²⁴ The section begins by addressing the main securities registration²⁵ and antifraud²⁶ statutes through which the SEC regulates cross-border ICOs. It further explains how a Utah federal district court judge in 2017 held that section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")²⁷ restores the "conduct and effects test" with respect to SEC court enforcement actions.²⁸ This test authorizes the SEC to bring fraud claims concerning securities bought or sold entirely outside the U.S. or involving entirely foreign investors so long as wrongful conduct related to the ICO, such as pre-sale activity, occurred in or had a foreseeable substantial effect in the U.S.²⁹ Lastly, the Note concludes that the extensive extraterritorial reach of the conduct and effects test contravenes the very essence of Regulation S's safe harbor for extraterritorial offerings and the U.S.'s longstanding territorial approach to securities regulation.

I. Background

A. What Is a Cryptocurrency?

A cryptocurrency is a decentralized, peer-to-peer digital currency that is used similarly to money.³⁰ It "functions as a medium of exchange, unit

23. 328 U.S. at 301.

24. *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 248 (2010).

25. 15 U.S.C. §§ 77e(a), 77e(c) (2012).

26. *Id.* § 78j(b) (2010) (prohibits certain deceptive practices "in connection with the purchase or sale of any security"); 17 C.F.R. § 240.10b-5 (2017) (adopting similar language); *Id.* § 77q(a) (forbids deceptive practices "in the offer or sale of any securities" regardless of scienter).

27. Pub. L. No. 111-203, § 929P(b), 124 Stat. 1376, 1864-65 (2010).

28. *See SEC v. Traffic Monsoon, LLC*, 245 F. Supp. 3d 1275, 1294 (D. Utah 2017).

29. *See id.* (finding that the issuer made "significant steps" in the U.S. in furtherance of the sale of fraudulent securities for purposes of 10b-5 liability because he created and promoted the securities while physically residing in the U.S., although 90% of the sales were made to foreign investors).

30. *Investor Alert: Bitcoin and Other Virtual Currency-Related Investments*, SEC (May 7, 2014), <https://investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-bitcoin-other-virtual-currency> [hereinafter *Investor Alert: Bitcoin*]; Noelle Acheson, *What Is Bitcoin?*, COINDESK, <https://www.coindesk.com/information/what-is-bitcoin/> (last updated Jan. 26, 2018) [<https://perma.cc/2HSW-HD8V>].

of account, or store of value.”³¹ Because it has an equivalent market value in real currency, it can be exchanged for traditional currencies, such as the U.S. dollar or the euro.³² Bitcoin is an example of this type of “convertible” digital currency.³³ Convertible digital cryptocurrencies can be used to purchase goods or services online.³⁴ They are also used to trade investments and transfer money.³⁵ Although a cryptocurrency operates similarly to a real currency, it has several important features that distinguish it from conventional government-backed currencies.³⁶

The most important characteristic distinguishing a cryptocurrency from conventional currency is that it is decentralized.³⁷ This means that no single person or central authority governs it.³⁸ It is also not backed by any government because it is not a legal tender.³⁹ Unlike U.S. dollars or euros which are printed by a treasury and central banks, cryptocurrencies are digitally created by networks of people that anyone can join.⁴⁰ These networks also process transactions made with the cryptocurrencies, effectively making their own self-operated payment networks.⁴¹

Governments have struggled to regulate these cryptocurrency networks because they are global and extremely intricate.⁴² For example, the Bitcoin has an expansive peer-to-peer network comprised of millions of computers all over the world that are connected via the internet.⁴³ Through a process called “mining,” these computers solve complex mathematical formulas to electronically create Bitcoins and process Bitcoin trans-

31. I.R.S. Notice 2014-21 at 1, <https://www.irs.gov/pub/irs-drop/n-14-21.pdf> [<https://perma.cc/S4WS-SUGV>].

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. See Acheson, *supra* note 30; Rainer Bohme et al., *Bitcoin: Economics, Technology, and Governance*, 29 J. ECON. PERS. 213, 219 (2015).

37. Bohme et al., *supra* note 36, at 219.

38. *Id.*

39. I.R.S. Notice 2014-21, *supra* note 31, at 1.

40. Acheson, *supra* note 30.

41. *Id.*

42. See e.g., *Investor Alert: Bitcoin*, *supra* note 30 (noting that U.S. law enforcement and SEC officials face inherent difficulty in investigating the illicit use of cryptocurrencies, like Bitcoin, because the transactions are encrypted; it is difficult to trace the flow of money because traditional banks are not involved; there is no central authority that collects user information; transactions and users span the globe; and the SEC is often unable to obtain information located overseas); see also Bohme et al., *supra* note 36, at 231 (“A key challenge for prospective regulators is where to impose constraints. It is infeasible to regulate all peers in the Bitcoin network due to their quantity, their geographic distribution, and the privacy protections in the network.”).

43. See *Neighbourhood Pool Watch: Bitcoin Mining Pool, Network, and Exchange Analysis - August 23, 2015 Network Statistics*, ORGAN OFCORTI (Aug. 23, 2015), <http://organofcorti.blogspot.com.au/2015/08/august-23rd-2015-network-statistics.html?q=%22number+of+miners%22&view=snapshot> (estimating that there are over 100,000 Bitcoin miners in mining pools with tens to hundreds of computers each) [<https://perma.cc/43CY-AV8F>].

actions.⁴⁴ Every Bitcoin transaction is validated and transmitted by “nodes” to the public distributed ledger called the “blockchain.”⁴⁵ Just about anyone in the world with the specialized computer hardware can download the Bitcoin software and take part in the Bitcoin mining or node validation process.⁴⁶ This means that, in theory, one central authority cannot use monetary policy to shut down an entire Bitcoin network or to take Bitcoins away from its people,⁴⁷ as China attempted to do when it banned ICOs in September 2017.⁴⁸ Moreover, if some part of the Bitcoin network goes offline because of government regulation or for any other reason, the cryptocurrency keeps on transmitting because the Bitcoin has a global decentralized network of computers, consisting of an estimated 10,307 nodes as of May 15, 2018.⁴⁹ Thus, it has no single point of failure.⁵⁰

B. What is an Initial Coin Offering (“ICO”)?

1. Startups Use ICOs to Fundraise

An ICO is an alternative fundraising model similar to an equity crowdfunding. It is a process through which startups raise money to fund a business project by using distributed ledger technology to sell digital coins and tokens to investors.⁵¹ Investors in an ICO generally invest using money or cryptocurrencies like Bitcoin.⁵² They typically buy the cryptocurrency in the hope that the fundraised project will become successful after it launches and the value of the cryptocurrency will rise above

44. See Noelle Acheson, *How Bitcoin Mining Works*, COINDESK, <https://www.coindesk.com/information/how-bitcoin-mining-works/> (last updated Jan. 29, 2018) [<https://perma.cc/66LG-FZNL>].

45. *Id.*

46. *Id.*

47. See Acheson, *supra* note 30; Bohme et al., *supra* note 36, at 219.

48. See Lulu Yilun Chen & Justina Lee, *Bitcoin Tumbles as PBOC Declares Initial Coin Offerings Illegal*, BLOOMBERG (Sept. 4, 2017), <https://www.bloomberg.com/news/articles/2017-09-04/china-central-bank-says-initial-coin-offerings-are-illegal> (“China’s central bank said initial coin offerings are illegal and asked all related fundraising activity to be halted immediately. . . . The regulator said that those who have already raised money must provide refunds, though it didn’t specify how the money would be paid back to investors.”) [<https://perma.cc/KQ8E-K54F>]; Kenneth Rapoza, *China’s ‘Bitcoin Ban’ No Match For Stateless Cryptocurrency Market*, FORBES (Oct. 18, 2017), <https://www.forbes.com/sites/kenrapoza/2017/10/18/chinas-blockchain-bitcoin-ban-no-match-for-stateless-cryptocurrency-market/#1430852de6bf> (explaining how Chinese investors have found ways around China’s September 2017 ICO ban by shifting to more peer-to-peer investing done in private, investing using crypto wallet accounts formed in other countries, and using foreign ICO platforms to target Chinese investors) [<https://perma.cc/27CC-5VFX>].

49. *Global Bitcoin Nodes Distribution*, BITNODES, <https://bitnodes.earn.com/> [<https://bitnodes.earn.com/>].

50. See Bohme et al., *supra* note 36, at 219 (stating that Bitcoin’s decentralized system prevents the concentration of power so that no individual or entity could take control over the network, and it has no central point of failure).

51. L.S., *What Are Initial Coin Offerings?*, THE ECONOMIST (Aug. 22, 2017), <https://www.economist.com/blogs/economist-explains/2017/08/economist-explains-17> [<https://perma.cc/55SC-HJWV>].

52. *Id.*

what they purchased it for.⁵³ Similar to a stock, the cryptocurrency serves a dual purpose: it may represent ownership rights in the company or a unit of value that can be traded for profit on a secondary market.⁵⁴

2. ICOs are Inherently Risky

ICOs raise concerns of money laundering, fraud, and theft.⁵⁵ The cryptocurrency issued in an ICO is decentralized and encrypted, meaning it is difficult to track its sale and the identity of the individuals behind it.⁵⁶ Moreover, the high-risks of investing in ICOs are not yet well understood by investors, who can be easily lured with the promise of high returns in a new investment space.⁵⁷ This risk is exacerbated by the fact that startups with little or no operating history use ICOs to raise capital quickly without having to disclose substantive information to investors.⁵⁸ Ultimately, these risks are difficult to ameliorate. In theory, any person in the world with an internet connection and a digital wallet can participate in an ICO, making an ICO difficult to regulate by any single country. This creates opportunities for criminals to launder money, finance terrorism activities, and carry out other fraudulent schemes across borders, particularly in countries where corruption is rampant.⁵⁹

3. The U.S. Regulators Are Increasing Regulatory Efforts to Target Cross-Border ICOs

In the U.S., the SEC is leading the regulation against cryptocurrencies, albeit slowly. In July 2017, four years after the first ICO, the SEC cautioned that “some” ICOs “may” be considered securities subject to the federal securities laws.⁶⁰ But the SEC has not provided clear guidance on the legality of different types of ICO structures or how it will regulate them. Indeed, to date the SEC has not issued any formal rules governing ICOs.⁶¹ Nor has a single ICO issuer registered its cryptocurrency offering under a S-1 filing with the SEC.⁶² Instead, most of the recent ICOs have bypassed SEC vetting altogether by filing Form Ds, which permit issuers to exempt

53. *Id.*

54. *Id.*

55. See *Investor Alert: Bitcoin*, *supra* note 30.

56. Bohme et al., *supra* note 36, at 219.

57. See *Investor Alert: Bitcoin*, *supra* note 30.

58. *Id.*

59. See Bohme et al., *supra* note 36, at 230.

60. *SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities*, *supra* note 8.

61. Rather, the SEC has imposed a “I will know it when I see it” standard as its framework for classifying ICOs as regulatable securities. See *id.* (“Whether a particular investment transaction involves the offer or sale of a security – regardless of the terminology or technology used – will depend on the facts and circumstances, including the economic realities of the transaction.”); Brady Dale, *Ex-SEC Lawyer Predicts ‘Assembly Line’ for ICO Enforcement*, COINDESK (Nov. 26, 2017), <https://www.coindesk.com/sec-icos-nicolas-morgan-paul-hastings/> (last updated Nov. 27, 2017) [<https://perma.cc/H274-BKSA>].

62. McKenna & Marriner, *Here’s the Blueprint for How ICOs Are Getting off the Ground Without SEC Vetting*, MARKETWATCH (Feb. 22, 2018), <https://www.marketwatch.com/story/here-s-the-blueprint-for-how-icos-are-getting-off-the-ground-without-sec-vetting-2018-02-22>.

their cryptocurrency offerings from registration.⁶³ Some hypothesize that the reason the SEC has been slow to regulate ICOs is because of jurisdictional limitations; many ICOs are cross-border transactions and attract buyers from around the world. Others argue, as the SEC Chairman has conceded, that it is often unclear whether the coins or tokens are securities.

Despite these setbacks, the SEC has made significant strides in halting fraudulent ICOs. Between the SEC's initial July 2017 warning and May 2018, the SEC has initiated five lawsuits and one administrative enforcement proceeding in connection with ICOs for the violation of the antifraud and registration provisions of the Securities Act and Exchange Act.⁶⁴ Notably, one of these lawsuits involves a foreign ICO issuer, and nearly all of these lawsuits concern ICOs that made sales to foreign investors.⁶⁵ Although none of the federal judges presiding in these cases has yet ruled whether the ICOs are securities, three federal judges have already issued preliminary injunctions halting three allegedly fraudulent ICOs, including one Canadian offering.⁶⁶ In each case, the judges determined that the SEC had made a substantial showing of likelihood of success that the ICOs were securities.⁶⁷ Although final rulings are still pending as of the date of this Note, these cases predict how those courts will ultimately rule on the security issue.

The U.S. Commodity Futures Trading Commission ("CFTC") is also playing an increasingly important role in the global regulation of cryptocurrencies that are traded after an ICO. The CFTC first announced that cryptocurrencies are commodities under the Commodity Exchange Act in 2015.⁶⁸ It filed its first lawsuit in connection with a Bitcoin-trading Ponzi scheme in September 2017.⁶⁹ In January 2018, the CFTC began to aggressively crack down on the trading of cryptocurrencies following its joint statement with the SEC saying that both agencies would "bring actions to stop and prevent fraud in the offer and sale of digital instruments." Within a few days of the release of statement, the CFTC brought three lawsuits against allegedly fraudulent cryptocurrency investment schemes, including one lawsuit against a United Kingdom-registered company who operated an alleged Ponzi scheme in which he solicited at \$1.1 million from more than 600 investors worldwide.⁷⁰ These actions are a further sign that the U.S. derivatives and securities regulators are collaborating to police cross-border cryptocurrency schemes.

com/story/number-of-icos-getting-regulation-lite-treatment-is-growing-2018-02-21 [https://perma.cc/DX5M-PFJ7].

63. *Id.* (revealing that 83 ICOs that were transacted between 2017 and 2018 filed SEC Form Ds to exempt their offerings from SEC registration).

64. See Gottlieb, *supra* note 11, at 1-2, 6-8.

65. See *supra* note 19 and accompanying text.

66. See *id.*

67. See *id.*

68. See *In re Coinflip, Inc.*, CFTC Docket No. 15-29, available at <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliporder09172015.pdf> [https://perma.cc/6E43-W25T].

69. See *CFTC v. Gelfman*, No. 1:17-cv-07181-PKC (S.D.N.Y. Sept. 21, 2017).

70. See *CFTC v. Dean*, No 2:18-cv-00345 (E.D.N.Y. Jan. 18, 2018).

The U.S. Financial Crimes Enforcement Network (“FinCEN”) is also stepping in to combat money laundering and terrorism financing in connection with ICOs. On March 6, 2018, it released a letter stating that developers that sell “convertible virtual currency” in the form of “ICO coins or tokens” are money service business and must comply with bank secrecy and know-your-customer regulations.⁷¹ The statement follows FinCEN’s July 26, 2017 action in which it assessed civil monetary penalties against a foreign located cryptocurrency exchange for violating U.S. anti-money-laundering laws and complicity in Bitcoin-related criminal enterprises.⁷² This highlights the previously unspoken principle that a foreign entity operating as a money services business with activities in the U.S. will be subject to regulation.

ANALYSIS

II. The SEC Has Congressional Authority to Regulate Most ICOs

In enacting the federal securities laws, Congress sought to protect U.S. investors in “securities,” as that term is defined under the Securities Act and the Exchange Act.⁷³ Over the last seventy years, the U.S. regulators and courts have developed a variety of standards to determine whether investments in anything ranging from citrus groves to online virtual games constitute securities and are therefore subject to the federal securities laws. The federal courts, however, are grappling to understand the novel concept of a “cryptocurrency” and how to classify cryptocurrencies that are distributed in ICOs.⁷⁴ This section seeks to provide some clarity by demonstrating how the economic reality of most purchases of cryptocurrencies in ICOs are more akin to securities rather than non-security purchases of commodities or rights. Ultimately, rather than guess anew in each case, the courts should apply this presumption in all cases, preserving a stable

71. Dep’t of the Treasury, Comment Letter on the Financial Crime Enforcement Network Under the Bank Secrecy Act in Connection with Virtual Currencies (Feb. 13, 2018), <https://coincenter.org/files/2018-03/fincen-ico-letter-march-2018-coin-center.pdf>.

72. In Re BTC-E, No. 2017-03, https://www.fincen.gov/sites/default/files/enforcement_action/2017-07-26/Assessment%20for%20BTCeVinnik%20FINAL%20SignDate%2007.26.17.pdf [<https://perma.cc/VG7S-E7GL>].

73. See 15 U.S.C. §§ 77a-77aa (2012) (focusing on the offer and sale of “securities”); 15 U.S.C. §§ 78a-78qq (2016) (same).

74. The federal courts are evaluating whether ICOs are securities that can be regulated by the SEC. See Hurtado, *supra* note 17. To date, there is no court precedent that answers this question because the limited number of SEC enforcement proceedings that have considered whether an ICO or a similar cryptocurrency investment scheme is a security have been uncontested. See Prelim. Inj. as to Defs. Jared Rice Sr. and AriseBank, SEC v. AriseBank, No. 3:18-cv-00186-M (N.D. Tex. Mar. 9, 2018), ECF No. 61 (unopposed preliminary injunction); In re Munchee Inc., Securities Act Release No. 10445 at 1 (Dec. 11, 2017) (unopposed cease-and-desist order); In re Erik Vorhees, Securities Act Release No. 9592 at 1 (June 3, 2014) (same). *But cf.* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 at 1 (July 25, 2017) (dropping charges but concluding that the token offering was a security).

background against which the SEC and courts can regulate with predictable effects.

A. What is a Security?

The definition of a security under section 2(a)(1) of the Securities Act and section 3(a)(10) of the Exchange Act includes broad categories of financial instruments, such as profit-sharing agreements and investment contracts.⁷⁵ Congress intended this broad definition to apply not only to the financial arrangements known to Congress at the time the statutes were enacted, but also to any prospective, novel instruments created by those who seek to use the money of others on the promise of profits.⁷⁶

B. Most ICOs are Securities Because They Are Investment Contracts Under the *Howey* Test

ICOs are not, by default, securities because they are not included within the statutory definition of a security, but they fall squarely within the category of an investment contract. Supreme Court decisions dating back to *SEC v. W.J. Howey Co.* have defined an investment contract as a contract, transaction, or scheme whereby an individual (1) invests money, (2) in a common enterprise, and (3) is led to expect profits (4) solely from the efforts of the promoter or a third party.⁷⁷ In concluding that the transactions were investment contracts, the Supreme Court in *Howey* determined that the individuals who invested in a small tract of land used as a citrus grove were offered more than just the sale of land.⁷⁸ They were induced by the opportunity to contribute money and to share in the profits of a large citrus fruit enterprise.⁷⁹ The Supreme Court explained:

[A]ll the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed.⁸⁰

Thus, the Supreme Court in *Howey* deliberately did not present a single, determinative factor in defining an investment contract but rather looked to the investment package as a whole, including the ways in which the investment was marketed to investors. Accordingly, the test for whether an ICO is a security requires a factual inquiry into the economic reality of the transaction.⁸¹ Each of the four *Howey* elements must be viewed in that vein

75. 15 U.S.C. § 77b(a)(1) (2012); 15 U.S.C. § 78c(3)(a)(1) (2016).

76. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

77. *Id.* at 298-99; *Long v. Shultz Cattle Co.*, 881 F.2d 129, 132 (1989) (applying the *Howey* test).

78. *Howey*, 328 U.S. at 299.

79. *Id.* at 300.

80. *Id.*

81. *Id.* at 298.

and satisfied before a court will conclude that an ICO is a security.⁸² That inquiry is conducted below.

1. SEC v. Shavers: Cryptocurrencies are an “Investment of Money”

The notion that cryptocurrencies constitute an “investment of money” was first settled in *SEC v. Shavers*.⁸³ In that case, which represents the first SEC lawsuit in connection with a fraudulent cryptocurrency investment scheme, the U.S. District Court for the Eastern District of Texas entered a judgment against Trendon T. Shavers, a Texas man, and his Texas-based company, Bitcoin Savings and Trust (“BTCST”) for defrauding investors in a \$4.5 million Ponzi scheme involving Bitcoin.⁸⁴ Shavers offered and sold Bitcoin-denominated investments through the internet and promised investors up to seven-percent weekly interest based on BTCST’s proclaimed Bitcoin market arbitrage activity.⁸⁵

Shavers challenged the SEC’s jurisdiction on the contention that the BTCST investments were not investment contracts under *Howey* because investors paid for the interest in Bitcoins.⁸⁶ He argued that Bitcoins are not currency that can be regulated and, therefore, the interests did not involve an “investment of money.”⁸⁷ The court disagreed and drew a distinction between the issue of whether Bitcoin itself is “money” and whether the BTCST investments, taken as a whole, including the ways in which they were marketed to investors, are “investment contracts.”⁸⁸

In its August 26, 2014 ruling, the court held that the BTCST investments were investment contracts under *Howey*. The court determined that Bitcoin (1) was an investment of money because it could be “used as” money or currency; (2) there was a common enterprise in that investors were dependent on Shavers’s expertise in Bitcoin markets and his local connections; and that the investors (3) expected profits in the form of weekly interest (4) solely from the efforts of Shavers’s Bitcoin arbitrage activity.⁸⁹ Accordingly, the court concluded that Shavers and BTCST violated the registration and antifraud provisions of the federal securities laws and ordered them to pay more than \$40 million in disgorged profits and civil penalties of \$150,000 each.⁹⁰ Shavers was also sentenced to eighteen months in prison.⁹¹

82. See *Shultz Cattle*, 881 F.2d at 132 (interpreting the *Howey* test).

83. No. 4:13-CV-416, 2014 WL 12622292, at *6 (E.D. Tex. Aug. 26, 2014) (order granting in part and denying in part defendants’ motion for reconsideration and holding that the Bitcoin-denominated investment scheme was a security).

84. *Id.* at *2.

85. *Id.* at *6.

86. *Id.* at *1.

87. *Id.* at *5-6.

88. *Id.* at *4.

89. *Id.* at *1, *6.

90. *Id.*, 2014 WL 4652121, at *13 (E.D. Tex. Sept. 18, 2014) (order granting summary judgment in favor of the SEC).

91. *Trendon Shavers Sentenced in First Bitcoin Securities-Fraud Case*, WALL ST. J. (July 21, 2016, 6:45 PM), <https://www.wsj.com/articles/trendon-shavers-sentenced-in-first-bitcoin-securities-fraud-case-1469141141>.

Shavers did not concern an ICO, but it answers the important question of whether an “investment of money” under *Howey* needs to take the form of legal tender. Future courts analyzing *Shavers* should similarly conclude that it is immaterial whether investors use cash or cryptocurrency to buy into ICOs. In either scenario, investors still “give up *something of value*.”⁹²

2. SEC v. SG Ltd.: *Investors in a Virtual Entity Create a “Common Enterprise”*

Notably, the *Shavers* court did not specify why the Bitcoin-denominated Ponzi scheme was a “common enterprise” within the meaning of the second prong of the *Howey* test because the issue was uncontested.⁹³ Other federal courts that considered this question have, however, held that investments in virtual enterprises satisfy the commonality requirement.

This issue was squarely addressed in *SEC v. SG Ltd.*⁹⁴ In that 2001 case, the SEC sued a virtual stock exchange for defrauding investors through its cyberspace game.⁹⁵ SG Ltd., a Dominican corporation, had misled investors by promising unrealistic rates of return and then refused to allow them to redeem their earnings.⁹⁶ The company argued, in part, that the virtual shares were part of a legitimate fantasy investment game created for the personal entertainment of *each* player and therefore there was no “commonality” among the players to implicate the federal securities laws.⁹⁷

In holding that the virtual shares in the online game were securities, the First Circuit Court ruled that a showing of “horizontal commonality” satisfies the *Howey* test. Horizontal commonality is shown by the “pooling of assets from multiple investors in such a manner that all share in the “profits and risks” of the enterprise.”⁹⁸ The court found that horizontal commonality was established here in two ways: (1) the company ran a Ponzi scheme whereby it depended on a continuous influx of new money from new members to remain in operation, and (2) the company operated a pyramid scheme whereby it promised to pay current members twenty to thirty percent referral fees, which were to be paid out of the money contributed by the new referrals.⁹⁹

The SG court’s decision has important implications in the context of ICOs. Issuers who are involved in Ponzi or pyramid schemes will automatically be deemed to have satisfied the commonality prong of the *Howey* test. Additionally, nearly every ICO to date satisfies the horizontal commonality requirement because the very essence of an ICO is the “pooling of assets” and the sharing in the “profits and risks” of the fundraised project.¹⁰⁰

92. *Shavers*, 2014 WL 12622292, at *6 (emphasis added).

93. See *id.* at *5.

94. 265 F.3d 42 (1st Cir. 2001).

95. *Id.*

96. *Id.* at 44-45.

97. See *id.* at 44, 52-53.

98. *Id.* at 50.

99. *Id.* at 51-52.

100. See Acheson, *supra* note 30.

3. In re Munchee Inc.: ICOs Provide a “Reasonable Expectation of Profits”

In December 2017, the SEC made another significant stride in bringing a cryptocurrency offering under *Howey* in *In re Munchee Inc.*¹⁰¹ In its second administrative enforcement proceeding against an ICO issuer, the SEC issued an unopposed cease-and-desist order that shut down Munchee, a California business involved in a token sale.¹⁰² Munchee created an iPhone application (“app”) for people to review restaurant meals and to purchase food.¹⁰³ Munchee was seeking to raise \$15 million through the token sale to improve its app and to recruit users to buy advertisements, write reviews, sell food, and conduct other transactions using its “MUN token.”¹⁰⁴

Munchee told investors that because the MUN tokens would be used primarily for consumption purposes in the iPhone app, they were “utility tokens” and not “securities.”¹⁰⁵ The SEC disagreed, stating that whether the token offering is a security does not turn on whether it is labeled as a “utility token” but on the “economic realities” of the underlying transactions. The SEC recognized that the MUN tokens were intended to be used primarily for consumption, including to purchase food and other services in the iPhone app.¹⁰⁶ It found, however, that “[e]ven if [the] MUN tokens had a practical use at the time of the offering, it would not preclude the token from being a security.”¹⁰⁷ The SEC focused on how Munchee led investors to reasonably expect profits from (1) the appreciation of the value of the MUN tokens resulting from Munchee’s efforts in developing its app and its ability to create a restaurant services “ecosystem” and (2) the sale of the MUN tokens on the secondary trading market.¹⁰⁸ Accordingly, the SEC concluded that the MUN tokens were securities under *Howey* and that Munchee violated section 5 of the Securities Act for failing to register its offering.¹⁰⁹

The SEC’s order in *Munchee* has critical implications for the application of the third prong of the *Howey* test. Chiefly, it demonstrates the limited effectiveness of the “utility” versus “security” distinction in determining whether the offering gives rise to a “reasonable expectation of profits.”¹¹⁰ The SEC’s ruling strikes at the heart of the Supreme Court’s longstanding principle that an investor cannot be said to “reasonably

101. In re Munchee Inc., Securities Act Release No. 10445 at 1 (Dec. 11, 2017) (unopposed cease-and-desist order).

102. *Id.*

103. *Id.* at 1.

104. *Id.*

105. *Id.* at 3-4.

106. *Id.* at 8.

107. *Id.* at 9.

108. *Id.*

109. *Id.* at 10.

110. See Daniel N. Budofsky & Robert B. Robbins, *The Sec’s Shutdown of the Munchee ICO*, PILLSBURY (Jan. 2, 2018), <https://www.pillsburylaw.com/en/news-and-insights/the-secs-shutdown-of-the-munchee-ico.html> [<https://perma.cc/6CCT-WUUB>], (describing how the *Munchee* order effectively eliminated the longstanding concept of the “utility

expect profits” when “he purchases a commodity for personal consumption or . . . for personal use.”¹¹¹ Accordingly, an ICO issuer can no longer escape the securities laws by characterizing its offering as a “utility” token or coin.¹¹² Rather, so long as the participants in the ICO have a liquid secondary market in which to trade the cryptocurrency and an expectation that the value of cryptocurrency will appreciate as a result of the efforts of the issuer, the participants will be deemed to have an “expectation of profits,” even if the underlying cryptocurrency has substantial existing utility at the time of the offering.¹¹³ Moving forward, the federal courts should apply the SEC’s rationale when considering whether investors are led to expect profits under the *Howey* test because it comports with Supreme Court precedent.¹¹⁴

4. *The DAO Investigation: ICOs Promise Returns That are “Derived from the Managerial Efforts of Others”*

Finally, the federal courts should also follow the SEC’s detailed guidance in its July 25, 2017 report of investigation (the “Report”) when considering the fourth prong of the *Howey* test because there is no federal directive on point. In that Report, the SEC concluded that the German corporation Slock.it UG and its co-founders had violated section 5 of the Securities Act through the offer and sale of tokens through a Decentralized Autonomous Organization (“DAO”).¹¹⁵ The DAO sold unique “DAO tokens” to fund projects.¹¹⁶ The holders of the DAO tokens shared in the anticipated earnings from these projects as a return on their investment in the DAO tokens.¹¹⁷ In addition, the DAO token holders could earn profits by re-selling their tokens through web-based platforms that supported secondary trading in the DAO tokens.¹¹⁸

Although the SEC declined to impose charges, the Report is insightful for future court application because it establishes two key factors for determining whether an ICO satisfies the fourth prong of the *Howey* test. Specifically, ICO participants will be deemed to rely on the managerial efforts of others to generate profits in an ICO when either (a) the efforts of the founders or third parties are “essential” to the success of the venture; or (b) the investors have “no meaningful control” over the venture’s operations. Both factors were established here.

token,” which many ICO issuers have relied on to avoid compliance with the Securities Act).

111. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 858 (1975).

112. See Budofsky & Robbins, *supra* note 110.

113. See *Munchee*, Securities Act Release No. 10445 at 9.

114. See, e.g., *SEC v. Edwards*, 540 U.S. 389, 390 (2004) (broadly defining expectation of “profits” to include “dividends, other periodic payments, or the increased value of the investment”).

115. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 at 1-2 (July 25, 2017).

116. *Id.* at 1.

117. *Id.*

118. *Id.*

The SEC determined that the managerial and entrepreneurial efforts of the project's co-founders and curators were "the 'undeniably significant' ones . . . essential to the overall success and profitability of any investment into the DAO."¹¹⁹ Specifically, the DAO's curators actively managed the investors' funds, monitored and resolved security breaches by hackers, and vetted and exerted significant control over the selection of business proposals on behalf of the investors.¹²⁰ Moreover, through their marketing materials, the co-founders of the DAO led investors to believe that the founders and curators hired to run the DAO's projects were "experts" with considerable experience in blockchain investing.¹²¹ On these facts, among others, the SEC concluded that the investors "had little choice but to rely on their expertise" to make the DAO a success.¹²²

The SEC also emphasized that the voting rights that the DAO token holders were afforded were far too limited to give them "meaningful control over the enterprise."¹²³ They were largely "perfunctory."¹²⁴ Investors could vote only on business projects pre-approved by the curators, did not receive sufficient information to make informed voting decisions, and their votes were meaningless because the curators could effectively override their votes by manipulating the quorum requirements.¹²⁵ Finally, the SEC emphasized that the widely-dispersed and numerous DAO token holders could not effectively communicate with one another, so they could not be deemed to be in a position to effectuate meaningful control.¹²⁶

The DAO investigation has several implications for future ICO issuers. Most significantly, it will be practically impossible for issuers to rely on the active participation of investors as a way to avoid coming under the fourth prong of the Howey test.¹²⁷

III. The SEC Has Considerable Extraterritorial Authority to Regulate ICOs

In the past year, almost all of the enforcement actions the SEC has brought have been charged under the securities registration requirements of the Securities Act¹²⁸ and the antifraud provisions of the Exchange Act.¹²⁹ The jurisdictional reach of that regulatory authority, however, has been brought into question by the international nature of many cryptocurrency-based schemes. This Note examines the scope of the SEC's extraterritorial authority to adjudicate cross-border ICO transactions.

119. *Id.* at 15.

120. *Id.* at 12-13.

121. *Id.* at 12.

122. *Id.* at 13.

123. *Id.* at 14.

124. *Id.*

125. *Id.*

126. *Id.*

127. *See id.* at 12-15.

128. Securities Act of 1933, §§ 5(a), 5(c), 15 U.S.C. §§ 77e(a), 77e(c) (2012).

129. Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (2010); 17 C.F.R. § 240.10b-5 (2017).

A. The SEC's Power to Enforce the Securities Registration Requirements of Section 5 of the Securities Act Has Considerable Force Outside the U.S.

Under the federal securities laws, the extraterritorial offering of cryptocurrencies poses serious challenges to defining the scope of section 5 of the Securities Act.¹³⁰ Section 5 requires an issuer to register its securities offering or qualify for an exemption from registration.¹³¹ The most common exemptions from the registration requirements are listed under Regulation D of the Securities Act and include private offerings to a limited number of persons or institutions;¹³² offerings of less than five million dollars;¹³³ and offerings to accredited investors.¹³⁴ Other Securities Act registration exemptions include intrastate offerings¹³⁵ and crowdfunding transactions, which the SEC recently added in 2015 when it adopted Regulation Crowdfunding in response to Title III of the Jumpstart Our Business Startups Act of 2012.¹³⁶

If an issuer fails to register its security offer or to satisfy any such registration exemption, section 5 prohibits the issuer from using interstate commerce to offer or sell its unregistered securities.¹³⁷ "Interstate commerce" is broadly defined by section 2(7) of the Securities Act to include "trade or commerce in securities or any transportation or communication relating thereto . . . between any foreign country and any State, Territory, or the District of Columbia."¹³⁸ The jurisdictional reach of the definition of interstate commerce is considerably extensive. A literal reading of the definition includes under section 5 any offering by a U.S. issuer, even an offering made entirely outside the U.S. and only to foreign investors, if in the process of selling the security abroad the issuer used the U.S. mails or made telephone calls into the U.S.¹³⁹ By the same reasoning, a foreign securities offering that was later resold among investors in the U.S. secondary markets would also trigger section 5's registration requirements.¹⁴⁰

The overreaching scope of section 5 and its inevitable conflict with the regulations of other countries prompted the SEC to take a series of steps to limit its application, including the adoption of Regulation S.¹⁴¹ Regulation S applies a territorial approach to the enforcement of section 5 of the Securities Act by providing an exemption from the registration requirements for

130. 15 U.S.C. §§ 77a-77aa (2012).

131. *Id.* § 77e.

132. 17 C.F.R. § 230.506(b) (2017).

133. *Id.* § 230.504.

134. *Id.* § 230.506(c).

135. § 3(a)(11), 15 U.S.C. § 77c (2012).

136. § 4(a)(6), 15 U.S.C. § 77d(a)(6) (2012).

137. *Id.* § 77e.

138. *Id.* § 77b(a)(7).

139. JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS*, 329 (3d ed. 2001).

140. *Id.*

141. Regulation S—Rules Governing Offers and Sales made Outside the United States Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.901-904 (1990) [hereinafter Reg. S], amended by 17 C.F.R. §§ 230.901-905 (1998).

offerings made “outside” the U.S. by both U.S. and foreign issuers.¹⁴² Because Congress intended for the Securities Act to protect domestic investors who purchase in the U.S. capital markets, Regulation S also provides safe harbor exemptions for the extraterritorial issuance and resale of unregistered securities.¹⁴³ Regulation S exemplifies the SEC’s territorial approach to securities regulation by recognizing the preeminence of the laws of the country in which the market and transaction are situated rather than the nationality of the purchasers or issuers.¹⁴⁴

Notwithstanding the territorial focus of Regulation S, the regulation still provides ample leeway for the SEC to regulate extraterritorial offers and sales of unregistered securities. Within the context of an ICO, for example, the SEC can prosecute a U.S. or foreign issuer who offers or sells its cryptocurrencies to persons in the U.S. or to an “identifiable group of U.S. persons abroad” without first registering with the SEC or qualifying for a registration exemption under Regulations D or S or another provision.¹⁴⁵ In theory, a single sale to an individual U.S. person is sufficient to trigger the SEC’s policing authority, should the aggregate foreign sale not meet an available exception.¹⁴⁶ Additionally, a sale is not needed to impose liability; the mere advertisement of an ICO in a publication “with a general circulation in the United States” is sufficient to subject the foreign ICO issuer to the federal registration requirements.¹⁴⁷

B. The SEC Has Broad Congressional Authority to Police Fraudulent Cross-Border Securities Transactions Under Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act

All security transactions that meet the definition of, even exempt transactions, are subject to the antifraud provisions of the federal securities laws.¹⁴⁸ Section 17(a) is a key antifraud provision in the Securities Act.¹⁴⁹ It holds issuers liable for fraudulent sales of securities.¹⁵⁰ Specifically, section 17(a) makes it unlawful to “employ any device, scheme, or artifice to defraud” or “obtain money or property” by using material misstatements or omissions or to “engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”¹⁵¹ This provision is closely followed by the other key antifraud

142. An offering or sale of securities occurs “outside the U.S.” when: “(1) The offer or sale is made in an offshore transaction; [and] (2) No directed selling efforts are made in the United States by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing.” 17 C.F.R. § 230.903 (2017).

143. *Id.*

144. Regulation S, Securities Act Release No. 6863, 46 SEC Docket 52 (Apr. 24, 1990).

145. 17 C.F.R. § 230.902(h)(2) (2012).

146. *Id.* § 230.902(c)(1).

147. *Id.* § 230.902(c).

148. *Id.* § 230.903.

149. Securities Act of 1933, § 17(a), 15 U.S.C. § 77q (2010).

150. *Id.*

151. *Id.*

prohibitions, section 10(b) and Rule 10b-5 of the Exchange Act.¹⁵²

Under these antifraud provisions, it is clear that ICO issuers who qualify for an exemption from the registration requirements of section 5 may nonetheless still be liable for materially false and misleading statements made in connection with their fundraising efforts. The question that has been heatedly debated in section 10(b) and 17(a) litigation, however, is whether these antifraud provisions apply to extraterritorial cryptocurrency offerings and whether they interfere with foreign securities regulation. To avoid that consequence, until 2010 the federal courts adopted a transactional approach to foreign securities regulation.

1. *Morrison v. Australian National Bank: The U.S. Securities Laws Apply Only to “Domestic Transactions”*

The leading case embracing the transactional approach to U.S. securities regulation is *Morrison v. National Australian Bank Ltd.*¹⁵³ In *Morrison*, the Supreme Court upheld the longstanding “transactional test,” which mandates that section 10(b) of the Exchange Act applies only to “transactions in securities listed on domestic exchanges, and domestic transactions in other securities.”¹⁵⁴ In reaching this decision, the Supreme Court rejected the “conduct and effects” test that the lower courts had used to determine whether a foreign transaction was covered by section 10(b) of the Exchange Act and section 17(a) of the Securities Act.¹⁵⁵ That test extended the antifraud provisions of the U.S. securities laws to an extraterritorial transaction if significant wrongful conduct related to the transaction occurred in the U.S. or if “the wrongful conduct had a substantial effect in the United States or upon United States citizens.”¹⁵⁶ *Morrison* clarified that the question of the extraterritorial reach of section 10(b) and Rule 10b-5 was not a jurisdictional issue, but rather a merits question of whether the Exchange Act governs non-domestic transactions.¹⁵⁷ Because there was no express congressional intent to rebut the longstanding presumption against extraterritoriality, the Supreme Court held that it did not.¹⁵⁸ Thus, it further held that the anti-fraud provisions of the Exchange Act apply “only to transactions in securities listed on domestic exchanges and domestic transactions in other securities.”¹⁵⁹

2. *SEC v. Traffic Monsoon, LLC: The Dodd Frank Act Restores the “Conduct and Effects” Test with Respect to Extraterritorial Transactions*

Less than a month after *Morrison* was decided, Congress enacted the Dodd-Frank Act. Section 929P(b) of Dodd-Frank codified the “conduct

152. Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (2010); 17 C.F.R. § 240.10b-5 (2017).

153. 561 U.S. 247 (2010).

154. *Id.* at 268.

155. *Id.* at 255, 267.

156. *Id.* at 257.

157. *Id.* at 247.

158. *Id.* at 263-64.

159. *Id.* at 249.

and effects” test for SEC court actions arising under sections 10b of the Exchange Act and 17(a) of the Securities Act.¹⁶⁰ This sparked considerable debate among the SEC and securities litigators as to whether section 929P(b) of the Dodd-Frank Act reinstated the conduct and effects test that had just been repudiated in *Morrison*, or whether section 929P(b) left the *Morrison* transactional test in place.¹⁶¹

The U.S. District Court for the District of Utah decided those questions in *SEC v. Traffic Monsoon, LLC*.¹⁶² The judge ruled that the Dodd-Frank Act did not explicitly overturn the core holding of *Morrison*—that the Exchange Act applies only to securities listed on domestic exchanges or certain domestic transactions.¹⁶³ It did, however, restore the conduct and effects test with respect to the *jurisdiction* of the courts to adjudicate SEC enforcement actions.¹⁶⁴ Under the slightly-modified conduct and effects test promulgated by the Dodd-Frank Act, the SEC can implicate the jurisdiction of the federal courts to prosecute foreign purchases and sales of securities, even if the securities transactions are made entirely outside the U.S. and involve only foreign investors, if significant steps in furtherance of the fraudulent conduct occurred in the U.S., or if the fraudulent conduct occurred outside the U.S. but had a foreseeable substantial effect in the U.S.¹⁶⁵ Under that test, the court held that the promoter’s mere creation and promotion of website advertising packages online while residing in the U.S. were “significant steps” to subject the promoter to liability under the federal securities laws, notwithstanding that ninety percent of the sales were made to foreign investors residing outside of the U.S.¹⁶⁶ Given the implication of this decision on international securities transactions, the judge in *Traffic Monsoon* immediately certified the case for appeal.¹⁶⁷ That appeal is still pending as of May 2018.

The *Traffic Monsoon* ruling is far more confusing than helpful in delineating the extraterritorial scope of the U.S. securities laws. Chiefly, *Traffic Monsoon* implies that the extraterritorial reach of the Exchange Act depends on the forum in which the statute is enforced. The decision suggests that the SEC has no congressional authority to regulate a foreign ICO in an administrative enforcement proceeding but it does if it proceeds in court. Whether Congress intended for this effect will be argued on appeal. Federal courts outside the U.S. Court of Appeals for the Tenth Circuit, however, will not be bound by the *Traffic Monsoon* appeal. Thus, until the Supreme Court decides the issue, the consequence under the Dodd-Frank Act will remain the same: the Exchange Act applies extraterritorially in court actions brought by the SEC if the conduct and effects test can be satisfied.

160. *SEC v. Traffic Monsoon, LLC*, 245 F. Supp. 3d 1275, 1288-89 (D. Utah 2017).

161. *Id.* at 1289.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.* at 1287, 1294.

167. *Id.* at 1303-04.

What is less clear, however, is how *Traffic Monsoon* implicates other directives of SEC enforcement. Section 929P(b) of the Dodd-Frank Act applies only to “wrongful” conduct, which requires a showing of an intent to deceive or negligence under section 10(b) of the Exchange Act¹⁶⁸ and section 17(a) of the Securities Act,¹⁶⁹ respectively. Thus, this raises the question of whether the SEC can utilize the conduct and effects test to bring suit against extraterritorial ICOs in cases in which only a violation of section 5’s registration requirements, which have a strict liability standard, is charged.¹⁷⁰

Perhaps the most fatal flaw of the *Traffic Monsoon* decision is the inconsistency and uncertainty in the application of the conduct and effects test. How does one determine what domestic acts constitute “significant steps” to avoid triggering the application of the securities laws for injury to foreigners abroad? In *Morrison*, the Supreme Court recognized that “merely preparatory activities” in the U.S. would not suffice.¹⁷¹ But this is exactly the opposite conclusion reached by the district court in *Traffic Monsoon*, which held that the promoter’s mere creation and promotion of the offering from a U.S.-based computer was sufficient to bring the entire foreign transaction (comprising ninety percent of the total sales) under the ambit of section 10(b) and Rule 10b-5.¹⁷²

In the context of an ICO, the *Traffic Monsoon* decision also makes it unclear when the online exchange of cryptocurrencies in the nascent stage of an ICO converts from a foreign transaction to a domestic one. This issue arises because the blockchain on which a cryptocurrency is based constantly expands as new “blocks” that record the most recent cryptocurrency transactions are added to the ledger.¹⁷³ The network supporting the blockchain operates across geographic borders and can be accessed by any individual who has permission.¹⁷⁴ Is the blockchain merely the record-keeping of an ICO but not the transaction itself, or is the blockchain an inseparable component of an ICO?¹⁷⁵

3. SEC v. PlexCorps: *There is Inherent Difficulty in Applying SEC v. Traffic Monsoon to a Cross-Border ICO*

The crux of these cross-jurisdictional challenges are exemplified by *SEC v. PlexCorps*.¹⁷⁶ In that enforcement action, the SEC brought suit against a Canadian ICO in the U.S. District Court for the Eastern District

168. 17 C.F.R. § 240.10b-5 (2017).

169. 15 U.S.C. § 77q(a) (2010).

170. Jared L. Kopel, *SEC Directs Regulatory Fire at Initial Coin Offerings*, THE RECORDER (Jan. 31, 2018), <https://www.law.com/therecorder/sites/legaltechnews/2018/01/30/sec-directs-regulatory-fire-at-initial-coin-offerings/> [https://perma.cc/62HY-LM45].

171. See *Morrison v. Nat’l Austl. Bank Ltd.*, 561 U.S. 247, 258 (2010).

172. See *Traffic Monsoon*, 245 F. Supp. 3d at 1294.

173. Kopel, *supra* note 170.

174. *Id.*

175. *Id.*

176. No. 1:17-cv-07007-CBA-RML, 2017 WL 5988934 (E.D.N.Y. Dec. 1, 2017).

of New York.¹⁷⁷ The SEC's complaint charges two Quebec residents and their unincorporated Canadian company PlexCorps for allegedly marketing and selling "PlexCoin," a cryptocurrency, to investors in the U.S. and other countries, resulting in a reported \$15 million in fraudulently obtained proceeds.¹⁷⁸

The SEC successfully obtained an asset freeze order and preliminary injunction against the defendants to preserve the investors' funds in Canada.¹⁷⁹ This prompted a heated debate between the parties over whether the district court could exercise personal jurisdiction over the Canadian defendants to adjudicate the SEC's registration and fraud claims.

The jurisdictional battle in this case highlights the potential challenges that will arise in offshore ICO enforcement actions after *Traffic Monsoon*. The PlexCorps defendants, like many foreign ICO promoters, took deliberate precautions to exclude U.S. persons from participating in the PlexCoin offering. It required all investors to confirm that they were not a U.S. citizen and were not purchasing the PlexCoins on behalf of a U.S. citizen.¹⁸⁰ As is common with most ICOs, however, the PlexCoin advertisements were in English and were distributed on the internet and on social media, including a Facebook page, that U.S. investors could access.¹⁸¹ Thus, PlexCorps raises the important question of whether prominent disclaimers and self-certification procedures in an offshore ICO are sufficient precautions to preclude a determination that wrongful conduct related to the ICO would have a "foreseeable substantial effect" in the U.S.

While this question has yet to be decided in connection with an ICO specifically, the answer is likely no. An offshore offer and solicitation of securities via the internet is not deemed to take place "in" the U.S. when the web site includes a prominent disclaimer that the offer is not directed to the U.S. and the promoter implements "reasonable" procedures to guard against sales to U.S. persons.¹⁸² These reasonable procedures include, at a minimum, collecting the purchaser's mailing address or telephone numbers prior to the sale.¹⁸³ The foreign issuer must also implement additional reasonable precautions when, like in PlexCorps, the offering materials are posted on third-party websites that have a significant number of U.S. subscribers, such as Facebook.¹⁸⁴ These more stringent precautions include limiting access to offering materials to persons who can

177. Complaint ¶ 1, *PlexCorps*, No. 1:17-cv-07007-CBA-RML (Dec. 1, 2017), ECF No. 1.

178. *Id.*

179. Order Granting Prelim. Inj., Asset Freeze, and Other Interim Relief at 7, *PlexCorps*, No. 1:17-cv-07007-CBA-RML (Dec. 14, 2017), ECF No. 25.

180. Letter Regarding Motion for Pre Mot. Conference at 2, *PlexCorps*, No. 1:17-cv-07007-CBA-RML (Dec. 21, 2017), ECF No. 27.

181. Compl. ¶¶ 7, 42-43, *PlexCorps*, No. 1:17-cv-07007-CBA-RML.

182. Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 33-7516 (Mar. 23, 1998), available at <https://www.sec.gov/rules/interp/33-7516.htm> [<https://perma.cc/Z9TN-YDA8>].

183. *Id.*

184. *Id.*

prove that they are not U.S. persons.¹⁸⁵ These precautions are not exhaustive.¹⁸⁶ If the foreign offeror has any indication that it has sold to U.S. persons, including, but not limited to, receiving notice that investors made payments using U.S. bank accounts as in *PlexCorps*, it must take other measures, as necessary, to prevent future sales to U.S. persons.¹⁸⁷ Although this criteria applies to determine whether an offshore internet offering targets U.S. investors and, therefore, implicates section 5's registration requirements, a similar framework has been applied to determine the "foreseeable" effect of extraterritorial fraudulent misconduct in the U.S.¹⁸⁸ Thus, the courts will likely apply this framework to ICOs to try to bring structure to a rather ambiguous "effects" test.

PlexCorps also raises the question of whether the use of U.S.-based online payment processors, such as PayPal and Square, to process offshore ICOs, alone or considered together with other pre-planning actions, is sufficient U.S. "conduct" to maintain personal jurisdiction under section 929P(b) of the Dodd-Frank Act. In *Traffic Monsoon*, minor U.S. pre-sale marketing efforts alone were sufficient.¹⁸⁹ But it is unclear whether the "conduct" test is met in *PlexCorps*, where the only U.S. pre-sale activities were agreements with third party payment processors.¹⁹⁰

4. The SEC's International Enforcement Assistance Program Under the Exchange Act

PlexCorps further underscores another important challenge for the SEC in future enforcement proceedings targeting fraudulent ICOs that take place abroad: its ability (or lack thereof) to detect and prosecute foreign violators and to seize the proceeds of fraudulent offerings. Technological advances have facilitated the sale of cryptocurrencies across borders and increased investment opportunities for foreign investors. These same advances, however, also make it inherently difficult for the SEC to identify perpetrators and to stop their illegal activities.

This Note argues that the SEC already has the resources at its disposal to effectively regulate foreign securities by virtue of its authority under the international enforcement and assistance provisions of the Exchange Act. Specifically, section 21(a)(2) of the Exchange Act authorizes the SEC to assist foreign securities authorities in the investigation of securities frauds that violate any laws or rules relating to securities matters that the foreign securities authorities administer or enforce.¹⁹¹ The SEC can provide assis-

185. *Id.*

186. *Id.*

187. *Id.*

188. See, e.g., SEC v. Straub, 921 F. Supp. 2d 244, 254-58 (S.D.N.Y. 2013) (exercising jurisdiction over foreign defendants whose sole jurisdiction-conferring act was to make statements directed in part at U.S. investors).

189. See 245 F. Supp. 3d 1275, 1288-89.

190. See Compl. ¶¶ 93, 107, No. 1:17-cv-07007-CBA-RML.

191. *International Enforcement Assistance*, SEC (Oct. 16, 2014), www.sec.gov/about/offices/oia/oia_crossborder.shtml [<https://perma.cc/36AR-H9QH>] [*hereinafter International Enforcement*].

tance to a foreign governmental body regardless of whether the conduct in question is a violation of U.S. law.¹⁹² In providing assistance, the SEC can exercise a variety of compulsory tools, including compelling the production of documents and testimony from any person and entity, even if that person or entity cannot be regulated by the SEC.¹⁹³

Importantly, the SEC benefits significantly from these cooperative, reciprocal exchanges.¹⁹⁴ The SEC primarily assists foreign securities authorities who “agree[] to provide reciprocal assistance in securities matters” to the SEC.¹⁹⁵ The SEC is most inclined to assist foreign securities authorities who will in turn help the SEC investigate perpetrators who would otherwise fall outside of the SEC’s jurisdiction, either because the individual or entity resides outside of the U.S. or the conduct in question occurred in another country.¹⁹⁶ In essence, the geographic boundaries of the U.S. are not a limit to its enforcement abilities.¹⁹⁷ The SEC can, and often does, rely on its established goodwill and vast global alliance with foreign agencies to combat cross-border securities fraud.¹⁹⁸

5. *The SEC’s International Information-Sharing Arrangements Will Enable it to Regulate Cross-Border ICOs*

The SEC’s success in detecting, investigating, and prosecuting foreign securities violations is primarily attributable to the SEC’s information-sharing arrangements with foreign securities regulators.¹⁹⁹ The SEC largely utilizes multilateral and bilateral information-sharing arrangements with foreign authorities to carry out its international enforcement duties.²⁰⁰ These arrangements operate on the basis of memoranda of understanding (“MOU”) between the SEC and the foreign securities authorities.²⁰¹ The MOUs set forth the scope and terms of information-sharing among the MOU participants.²⁰² Importantly, they memorialize the intent of the parties to fully cooperate in international securities law enforcement.²⁰³

The prevailing information-sharing agreement governing cross-border securities regulation is the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Informa-

192. *Id.*

193. *Id.*

194. *See id.*

195. *Id.*

196. *See id.*

197. *See International Enforcement, supra* note 191.

198. *See id.* (listing various recent securities enforcement cases that were resolved with cooperation with foreign government agencies and involve foreign incorporated companies).

199. *See id.*

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

tion (“MMOU”).²⁰⁴ The MMOU was created in 2002 by the International Organization of Securities Commissions to provide a framework for combating cross-border fraud and to expand cooperation and information-sharing among foreign securities regulators.²⁰⁵ Today, it is the largest international multilateral information-sharing arrangement among securities regulatory bodies.²⁰⁶ The SEC was among the first agencies to sign the MMOU in 2002.²⁰⁷ As of 2018, there are 117 signatories to the MMOU, representing securities and derivatives regulators from over 100 countries.²⁰⁸

Pursuant to the MMOU, the securities regulators agree to provide information and assistance to other member regulators upon request.²⁰⁹ The type of assistance to be made to members is extensive.²¹⁰ Specifically, the regulators to the MMOU agree to share information and documents held in their possession.²¹¹ If the information that is requested is not in the regulators’ files, the regulator must make efforts to obtain the information and documents concerning the transactions.²¹² These documents often include bank and brokerage account information, including detailed confidential information regarding the beneficial owners of the accounts.²¹³ Finally, the regulators agree to take or compel a person’s statement or, when possible, testimony under oath, concerning the alleged violation.²¹⁴ The agency receiving the information is permitted to use it in civil or administrative enforcement proceedings.²¹⁵

The types of offenses for which information requests can be made are also extensive.²¹⁶ The list of permissible requests includes information regarding “misrepresentation of material information and other fraudulent or manipulative practices relating to securities and derivatives” and “the registration, issuance, offer, or sale of securities and derivatives.”²¹⁷

The MMOU has had a transformational effect on the SEC’s international policing efforts. It has greatly improved the ease and speed with which the SEC is able to obtain information concerning potential violations in other jurisdictions around the world.²¹⁸ As a result, the SEC can quickly and effectively pursue its international enforcement investiga-

204. *Multilateral Memorandum of Understanding Concerning Consultation Cooperation and the Exchange of Information (MMoU)*, ORGANIZATION OF SECURITIES COMMISSIONS (2018), <https://www.iosco.org/about/?subsection=MMoU> [<https://perma.cc/P5BG-5UGG>] [hereinafter *Multilateral Memorandum*].

205. *Id.*

206. *Id.*

207. *Id.*

208. *Id.*

209. *Id.*

210. *See id.*

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *See Multilateral Memorandum, supra* note 204.

216. *See id.*

217. *Id.*

218. *Id.*

tions.²¹⁹ Additionally, the MMOU has strengthened international cooperation in securities enforcement and incentivized countries with strict laws prohibiting information-sharing to pass legislation that will permit them to do so.²²⁰

This Note argues that the success of the MMOU will have significant implications in the context of ICO regulation. It will become exceedingly difficult for perpetrators to avoid detection and prosecution for failing to register their ICOs or for defrauding investors by moving their scams and fraudulent activities overseas. The SEC will utilize its extensive global network of law enforcement and governmental agencies to investigate and prosecute ICO issuers who violate the registration or antifraud provisions of the U.S. securities laws.

6. *The SEC's Strong Relationships with Foreign Criminal Authorities Will Facilitate Its International Securities Enforcement Efforts*

In addition to the MMOU and similar reciprocal information-sharing arrangements, the SEC has other methods by which it can obtain enforcement-related information concerning ICOs.²²¹ One way it can do so is by requesting information from foreign criminal agencies under various mutual legal assistance treaties administered by the United States Department of Justice.²²² Although less common, the SEC can also petition a U.S. court to send an information request to a judicial authority in another country.²²³ Under the concept of reciprocity, most foreign judicial authorities are willing to comply.²²⁴ For example, in 2011, the SEC issued 772 requests to criminal enforcement agencies in other countries for assistance with investigations.²²⁵ On the other hand, the SEC corresponded with 492 requests for information from foreign authorities.²²⁶

Ultimately, strong international cooperation among various international securities and criminal enforcement agencies will prove vital to the SEC's ability to promptly, effectively, and appropriately regulate the U.S. offer and sale of cryptocurrencies in cross-border ICOs.

Conclusion

To date, the handful of federal SEC enforcement lawsuits and administrative proceedings that have considered whether cryptocurrency transactions similar to ICOs are subject to the U.S. securities laws have concluded that they were investment contracts under the *Howey* test.²²⁷ In reaching these determinations, the courts and regulators have applied the same facts

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.*

223. *Id.*

224. *See id.*

225. *See Multilateral Memorandum, supra* note 204.

226. *Id.*

227. *See supra* pp.12-19.

and circumstances analysis from *Howey*.²²⁸ They disregard form for substance and emphasize the economic realities of the transactions.²²⁹ The focus is thus on the expectations of the investors and the future rights they are promised in connection with the cryptocurrency offering.²³⁰ Moving forward, future judges will likely draw upon these rulings and similarly conclude that the federal securities laws apply to most forms of ICOs.

The U.S. approach to the regulation of ICOs in cross-border transactions, however, requires reevaluation. The 2017 *Traffic Monsoon* decision, which restores the conduct and effects test under the Dodd-Frank Act with respect to extraterritorial securities offerings, has far-reaching implications.²³¹ That test empowers the SEC to bring fraud claims in court against virtually any foreign ICO, even those that occur entirely outside the U.S. and involve only foreign investors, so long as wrongful conduct occurred in or had a foreseeable substantial effect in the country.²³² As exemplified by *Traffic Monsoon*, however, the conduct and effects test has the potential to regulate mere pre-sale preparation activity in cases in which no purchase or sale is actually made in the U.S.²³³ This is conduct that is so far removed from any real meaningful connection to the U.S. If not overturned on appeal, the conduct and effects test will lead to the same inconsistent and inequitable applications of the antifraud provisions of the securities laws to transnational cases that prompted the Supreme Court to overturn the test in *Morrison* in the first place.²³⁴

Accordingly, in exercising this broad extraterritorial authority under the Dodd-Frank Act, the SEC should take precautions to prevent a tremendous overreach of international laws and towards foreign persons who are not subject to personal jurisdiction in the U.S. As Bitcoins and other cryptocurrencies go mainstream in the global capital markets, the SEC needs to take a more balanced approach to the regulation of cross-border transactions to avoid the judicial squandering of resources that are better served in targeting ICOs that pose the greatest risk of injury to what really matters: the U.S. markets and the investors that participate in them.

A balanced approach to domestic and foreign regulation of ICOs is one that promotes both the development of the cryptocurrency market and provides adequate protection to U.S. investors from the risk of participating in ICO transactions. These seemingly conflicting goals are, in fact, possible. The SEC already regulates other decentralized technology transactions like crowdfunding with great success on both fronts. The SEC should implement an approach that follows how it currently regulates crowdfunding. Certainly, the technology underlying crowdfunding and

228. See *id.*

229. See *id.*

230. See *id.*

231. SEC v. Traffic Monsoon, LLC, 245 F. Supp. 3d 1275 (D. Utah 2017).

232. See *id.* at 1294.

233. See *id.* at 1287 (finding that the issuer made “significant steps” in the U.S. because he created and promoted the securities while physically residing in the U.S., although 90% of the securities were sold to foreign investors located outside the U.S.).

234. See *Morrison v. Nat’l Austl. Bank Ltd.*, 561 U.S. 247, 260–61 (2010).

ICOs are vastly different, but the SEC has tools at its disposal to overcome any mechanical differences. For example, it should use the same technology that states use to regulate internet gambling to control the flow of digital coins and tokens purchased and sold in ICOs. To do this, the SEC and other relevant federal agencies can regulate the issuers and investors' virtual wallets, as is done with internet gambling. Regulators control the virtual wallets of gamblers by monitoring the credit card companies and financial institutions that facilitate the purchase of digital currency using a gambler's credit or bank savings. The SEC and other relevant federal agencies could easily adopt a similar approach.

While there are various regulatory approaches to wholly extraterritorial securities offerings that will satisfy Congress's twin aim of protecting U.S. investors and the U.S. capital markets from fraud and similar harm coming both from outside and within the country, the best approach to ICO regulation is a territorial one that focuses not on the place where the deception originated or on the nationalities of the offering participants, but rather on the location of the actual *purchase* and *sale* of the securities. It is those purchase-and-sale transactions and the parties or prospective parties to those transactions that the Securities Act and Exchange Act seek to regulate and protect. This approach is embodied by the domestic transactions test set forth in *Morrison* and should be applied in connection with all SEC regulation of ICOs.