



PROGRAM MATERIALS

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Recent Blockchain Class Action Settlements Provide Tips for Future Cases

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Overview

- Background Information
- Description and Result of Recent Class Action Suits Against Issuers of Initial Coin Offerings (“ICOs”)
- Case Outcomes & Takeaways
- Guidance for Future ICO Class Actions

Blockchain

- Decentralized ledger of transactions across a peer-to-peer network that allows participants to confirm transactions without a third-party/central clearing authority
- Difficult to manipulate
- Among other things, enables the existence of cryptocurrency

Cryptocurrency

- Digital or virtual asset designed to work as a medium of exchange that is secured by cryptography
- Exists on a blockchain that records all transactions



Classifying Cryptocurrencies

- Digital assets have been classified differently, depending on their use and other factors:
 - Money (FinCEN)
 - Commodity (CFTC)
 - Security (SEC)
 - Property (IRS)
- How governments and regulators will classify digital assets remains one of the biggest questions in the industry.
- Yet how a digital asset is categorized will determine which government body is responsible for monitoring it, how financial gains will be taxed, and how the cryptocurrency can be used in commercial transactions.

ICOs

- Fundraising mechanism by which a start-up offers the sale of its crypto token for its specific ecosystem



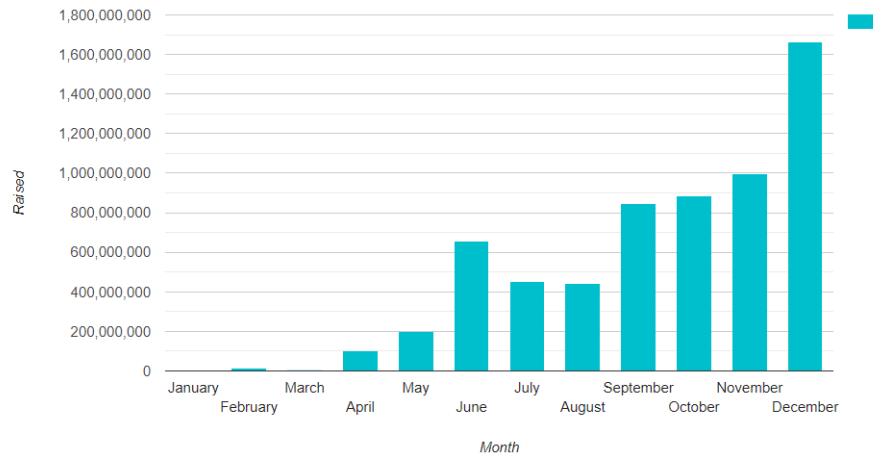
Boom of ICOs in 2017 and 2018

Funds raised in 2017

Total raised: **\$6,226,689,449**

Number of ICOs: **875**

2014 2015 2016 2017 2018

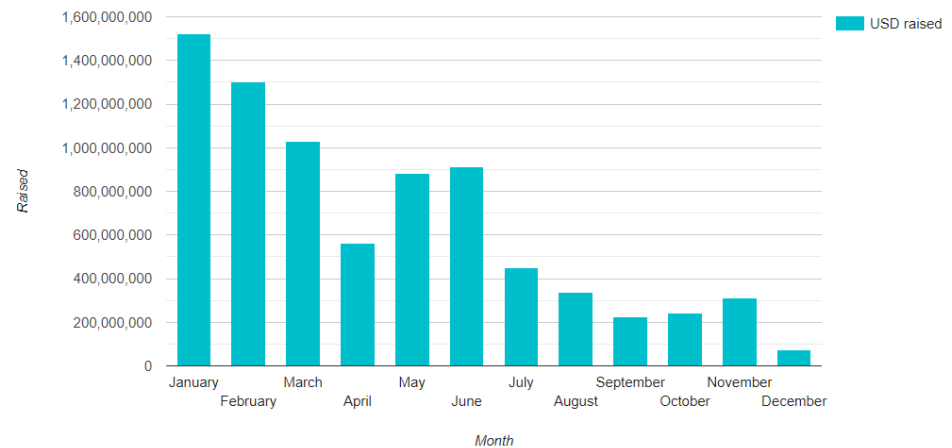


Funds raised in 2018

Total raised: **\$7,812,150,041**

Number of ICOs: **1253**

2014 2015 2016 2017 2018



SEC Guidance

SEC Report on The DAO token sale (July 2017)



B. DAO Tokens Are Securities

1. *Foundational Principles of the Securities Laws Apply to Virtual Organizations or Capital Raising Entities Making Use of Distributed Ledger Technology*

The DAO, an unincorporated organization, was an issuer of securities.

The Platforms that traded DAO Tokens appear to have satisfied the criteria of Rule 3b-16(a) and do not appear to have been excluded from Rule 3b-16(b). As described above, the

A system that meets the criteria of Rule 3b-16(a), and is not excluded under Rule 3b-16(b), must register as a national securities exchange pursuant to Sections 5 and 6 of the Exchange Act⁴¹ or operate pursuant to an appropriate exemption. One frequently used exemption is for alternative trading systems ("ATS").⁴² Rule 3a1-1(a)(2) exempts from the

Cease-and-Desist Order – Munchee, Inc. (Dec. 2017)



"Even if MUN tokens had a practical use at the time of the offering, it would not preclude the token from being a security." Determining whether a transaction involves a security does not turn on labeling – such as characterizing an ICO as involving a "utility token" – but instead requires an assessment of "the economic realities underlying a transaction."

SEC Statements & Enforcement

“There are different types of crypto-assets [...] Then there are tokens which are used to finance projects [...] **There are none that I’ve seen that are not securities.**” – SEC Chairman Jay Clayton, April 26, 2018

“ICOs that are securities most likely need to be registered with the SEC or fall under an exemption to registration.” – SEC Website

“[T]okens and offerings that feature and market the potential for profits based on the entrepreneurial or managerial efforts of others contain the hallmarks of a security under U.S. law.” – SEC Website

“The SEC is actively protecting investors from unregistered or fraudulent ICOs.” – SEC Website



**In 2019, ICO funding reportedly fell more than 95%,
and SEC enforcement actions continue.**

Tezos & ATB

- *In re Tezos Securities Litigation*,
Case No. 3:17-cv-06779 (N.D.Ca.)
- *Balestra v. ATBCOIN LLC*,
Case No. 1:17-cv-1001 (S.D.N.Y.)

Tezos – ICO

- “The last cryptocurrency”
- July 2017 ICO
- XTZ token sold for \$0.47 USD average.
- Raised \$232 USD million worth of bitcoin and ether



Tezos – Class Action Suit

- November 26, 2017
- Claims
 - Violations of Sections 5, 12, and 15 of the Securities Act of 1933
- Defendants
 - Kathleen and Arthur Breitman (California)
 - Dynamic Ledger Solutions, Inc. (California)
 - Tim Draper and his venture capital firm (California)
 - Tezos Foundation (Switzerland)
 - Bitcoin Suisse (Switzerland)

Tezos – Procedural Context and Defenses Raised

- May 15, 2018: Defendants moved to dismiss the case.
 - Lack of personal jurisdiction of foreign defendants
 - Lack of subject matter jurisdiction based on whether the token is a “security”
 - Case is barred by the Supreme Court’s *Morrison* decision
- Court allowed case to continue against Tezos and the Breitmans.
- Parties went through discovery and two rounds of mediation.
- Class moved for certification.

Tezos – Settlement

- Parties moved for settlement in March 2020.
- As of March 2020:
 - Tezos had assets in excess of \$630 million.
 - Tezos token was worth over \$3.00 USD, up from \$0.47 USD at the time of the ICO.
- Under the settlement, class members are to be paid \$25 million USD.

ATB – ICO

- “The fastest blockchain-based cryptographic network in the Milky Way galaxy”
- June through September 2017 ICO
- ATB token sold for \$1.27 USD average
- Raised more than \$200 million USD of bitcoin and ether



ATB – Class Action Suit

- December 17, 2017 – Investors filed a \$25 million USD lawsuit alleging that the ICO constituted the sale of unregistered securities.
- Claims
 - Violations of Sections 12 and 15 of the Securities Act of 1933
- Defendants
 - ATBCOIN LLC (Delaware)
 - Edward Ng (China)
 - Herbert Hoover (Indonesia)

ATB – Procedural Context & Defenses

- Defendants filed a motion to dismiss in April 2018.
 - Lack of personal jurisdiction over foreign defendants
 - Lack of subject matter jurisdiction as token is not a “security”
- Motion dismissed in its entirety
- Limited discovery conducted
- No motion for class certification prior to settlement

ATB – Settlement

- Parties moved for settlement in April 2020.
- Under the settlement, class members are to be paid \$250,000.
- Both parties conceded that defendant's did not have the ability to pay a more substantial judgment.
- May 2020 – ATB told the court it can no longer pay the agreed upon amount.

Takeaways

- First reported settlements of ICO class actions involving solely registration violations
- Drastically different outcomes for the plaintiffs in Tezos versus ATB
 - Ability to pay
 - Consequences of foreign defendants
 - Scope of class
 - Ascertaining and giving notice to class members
 - Procedural context

Ability to Pay

- Tezos
 - As of March 2020:
 - Assets in excess of \$630 million USD
 - Token worth over \$3.00 USD
- ATB
 - Negligible finances
 - No insurance
 - As of June 2020:
 - Token worth less than one cent USD

Consequences of Foreign Defendants

- Tezos founders, the Breitmans, located in California
- ATB founders, Ng and Hoover, located abroad
 - Personal jurisdiction
 - Discovery related to foreign defendants is difficult and more costly
 - Enforcement of a judgment against foreign defendants may be more difficult

Scope of Class

- Tezos – Persons who contributed bitcoin or ether to Tezos ICO, both in the United States and abroad.
- ATB – Persons who acquired ATB tokens during the ATB ICO “while located in the United States at the time of the transaction.”

Ascertaining and Giving Notice to Class Members

- Tezos
 - Class members were found primarily through information they provided during the ICO, such as email addresses and bank wire information.
 - Also able to ascertain class members through online platforms, such as Reddit and Twitter
- ATB
 - Class members were found through investor trading and defendant records.
 - Also able to ascertain class members through records such as confirmation from virtual currency exchanges and cryptocurrency wallet records

Procedural Context

- Tezos – A year of discovery, 2 rounds of mediation, motion for class certification
- ATB – No substantial discovery

Conclusions – Guidance for Future Cases

- Tezos and ATB cases show parties in ongoing class actions that less obvious and less traditional defenses and issues – specific to the nature of ICOs and blockchain technology – may well be the difference between a significant settlement and a trivial one.

Questions?

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Alerts

Tezos and ATB Cryptocurrency Class Action Cases Provide Guidance on Different Factors Driving Settlements Against ICO Issuers for Securities Laws Registration Violations

Alerts / June 4, 2020

On April 30, 2020, a federal court in San Francisco preliminarily approved a \$25 million class action settlement against the Swiss-based Tezos Foundation, its Californian founders, and other domestic and foreign firms directly involved in the 2017 initial coin offering (ICO) of its token, XTZ. The Tezos offering was conducted on a worldwide basis to both sophisticated, accredited investors and the general public, raising more than \$233 million. As of June 2, 2020, the XTZ token was ranked number 10 on CoinMarketCap at a price of \$3.08 per token. The \$25 million settlement amounts to about 10 percent of the total amount raised in the Tezos offering.

On April 10, 2020, another securities class action against Delaware-based ATBCOIN LLC (ATB) and its foreign founders, involving the 2017 ICO of the ATB token, preliminarily settled for \$250,000, which represents about 1 percent of the \$25 million in funds allegedly raised. Weeks later, on May 12, the attorney for the ATB defendants wrote to the federal judge in Connecticut presiding over the case, explaining that, upon further reflection, the defendants could not pay even that paltry settlement sum. The ATB token was ranked number 1,653 on CoinMarketCap at a price of \$.001188 per token as of June 2, 2020.

Class action lawsuits continue to be brought against ICO issuers, with a dozen new lawsuits recently filed against mostly foreign issuers and foreign individuals for similar registration violations in New York. While traditional reasons for settling class actions, such as risk of huge damages to a class, large litigation expenses and defendants' ability to pay, seem present in the proposed settlements in the Tezos and ATB cases, some unique issues attributable to these worldwide offerings of digital currencies may provide useful insights into the likely outcomes for parties involved in these newly filed and future ICO class actions.

I. A Tale of Two Cases

A. The Tezos Case

Tezos promised to be “the last cryptocurrency.” The Tezos blockchain was developed by Dynamic Ledger Solutions, Inc. (DLS), which was founded by a California-based husband-and-wife team, Arthur and Kathleen Breitman. DLS was funded in part by a venture capital firm run by the well-known venture capitalist, Tim Draper. In July 2017, the Tezos ICO was conducted by the Tezos Foundation, a Swiss entity, but with significant contacts with the United States – for example, it was allegedly founded, set up, and run by the Breitmans out of their California home. Bitcoin Suisse AG, a Switzerland-based financial service provider, acted as an intermediary in the ICO by providing virtual currency conversion services to foreign investors and then handling their ICO contributions. Throughout the ICO, XTZ was sold for roughly \$0.47 on average.

The Tezos capital raise took in \$232 million worth of bitcoin and ether,^[1] making it the largest ICO at the time. On November 26, 2017, investors filed suit in the Northern District of California, alleging that the Tezos ICO was an unregistered, and therefore illegal, securities offering. The two counts included violations of Sections 5, 12, and 15 of the Securities Act of 1933 (the Securities Act). The defendants included the Tezos Foundation, DLS, Bitcoin Suisse (a foreign firm), Tim Draper and his VC firm, and the Breitmans, as “control persons” of the Tezos Foundation under Section 15 of the Securities Act.

On May 15, 2018, the defendants moved to dismiss the case. Among the more interesting issues in the motion was whether the court had jurisdiction over the Tezos Foundation and Bitcoin Suisse, given that the ICO was meant to be directed solely to investors outside the United States.^[2] However, in a detailed decision by Judge Seeborg, the court largely denied the motion and allowed the case to proceed against the Breitmans and the Tezos Foundation (the motion was granted on jurisdictional or other grounds as to Bitcoin Suisse, Draper and his VC firm).

The remaining parties went through almost two years of heavy litigation, including more than a year of discovery and two rounds of mediation. In addition, the class moved for certification, proposing to define the class as all persons and entities who, directly or indirectly, contributed bitcoin or ether to the Tezos ICO during the offering conducted July 1-14, 2017. Throughout the litigation, the Tezos Foundation remained financially viable, reporting in March 2020 assets in excess of \$630 million,^[3] which was almost triple the amount it had raised in the ICO. The Tezos token itself is currently worth over \$3.00.

Late this March, the parties reached a settlement that required the class members be paid \$25 million. The plaintiffs for the class moved for the court's approval of the settlement and outlined the reasons for accepting it, including that the parties had fundamental disagreements on legal issues such as: (1) whether the Tezos tokens are "securities" under the federal securities laws; (2) whether investors were bound by the so-called "Contribution Terms"; (3) whether the defendants are "sellers" under Section 12(a)(1) of the Securities Act; (4) whether the Breitmans are controlling persons under Section 15 of the Securities Act; and (5) whether the Securities Act applies under the *Morrison* decision.^[4]

In more traditional class actions involving the securities of U.S. public companies, there are rarely material issues or defenses raised based on lack of personal jurisdiction over the foreign defendants, as there were here, or lack of subject matter jurisdiction based on whether the token sold was an "investment contract" and thus a "security" for federal securities purposes. Separately, to the extent all the "securities" transactions were foreign, the United States Supreme Court decision in *Morrison* might act as an independent ground to preclude the federal court from jurisdiction over the case. The parties also disputed the proper measure of damages – estimates presented by the parties during mediation discussions ranged from less than \$1 million to more than \$150 million.

Papers filed with the court provided extensive details on the mechanics of the settlement. Investors were from all over the globe, and they invested on a blockchain, where their identity was difficult to discern, unlike in more traditional class actions where all a claims administrator need do is obtain from a company's transfer agent the list of shareholders and place a public advertisement in a well-known business media outlet. Here, a professional claims administrator, Epiq Class Actions & Claims Solutions, Inc., was chosen to identify and communicate with class members, through Reddit and Twitter and elsewhere, assess their proof of claims, and conduct payouts. Epiq would primarily rely on information provided by class members to Tezos in connection with the ICO, such as their email addresses and bank wire information.

At a hearing on April 30th, the settlement was preliminarily approved by the court. A hearing is scheduled in August for final approval.

B. The ATB Case

The case arising from the ICO involving ATB, self-touted as "the fastest blockchain-based cryptographic network in the Milky Way galaxy," had a similar start. The ICO was conducted between June and September 2017. The ATB token was sold for about \$1.27, and the raise brought in more than \$20 million worth of cryptocurrency. But on December 21, 2017, investors filed a \$25 million lawsuit in the Southern District of New York, alleging that the ICO constituted the illegal sale of unregistered securities. The two counts alleged violations of Sections 12 and 15 of the Securities Act. Defendants included ATB (a Delaware corporation) and its founders and executives, Edward Ng (a resident of China) and Herbert Hoover (a resident of Indonesia). The defendants filed a motion to dismiss in April 2018, arguing that no federal securities laws were violated because the token was not a "security" and that the court lacked personal jurisdiction over Ng and Hoover. That motion was denied in its entirety in March 2019.

In April 2020, the parties entered into a stipulation to settle the case, and the lead plaintiff filed for court approval. But, unlike the Tezos class, the ATB class members were to receive pennies on their investment. Despite initially suing for \$25 million, the settlement amount was only \$250,000 – with about a third of that sum likely for attorney's fees. The lead plaintiff conceded to the court that the main focus in negotiating the settlement was the defendants' ability – or, more precisely, inability – to pay any judgment, representing that defendants were "judgment-proof," and that securing any recovery was "very likely to be difficult or impossible." This was especially the case with the two founders being foreigners living abroad.

The settlement also differed from Tezos because, here, the class had not moved for certification previously. Accordingly, the settlement papers explained for the first time why the class was certifiable, defining the class as all persons that purchased or otherwise acquired ATB tokens between June 12 and September 15, 2017, while located in the United States at the time of their transaction. The settlement papers also explained why the class was ascertainable—a certification requirement for the Second Circuit restricting a class to one whose members are truly determinable in practice.

Like traditional securities class actions, the settlement approval papers explained that class members could be identified through investor trading records and the defendants' records. However, the papers explained that class members were also identifiable through records such as confirmations from virtual currency exchanges and cryptocurrency wallet records. For example, the lead plaintiff provided documents that indicated that on August 21, 2017, he paid 2.100441 ether for 388.5 ATB tokens. These records, the class's counsel explained, could be cross-referenced against the relevant blockchains (containing unbroken ledgers detailing the nature of each transaction), thereby ensuring accuracy in ascertaining the class. The approval request proceeded to outline other proposed mechanics of the settlement, including the use of a professional claims administrator, Strategic Claims Services.

After these papers were filed, however, the ATB defendants apparently had second thoughts. On May 12, 2020, the defendants' counsel wrote to the court telling it that the defendants, "due to a change in circumstance," would not be able to fund the settlement.

II. Key Takeaways

The Tezos and ATB cases are apparently the first reported settlements of ICO class actions involving solely registration violations, as opposed to fraud claims, and the two could not have more different outcomes for the class members. Also, they both raise issues that are not usually found or raised as defenses in more traditional class action involving U.S. public companies and their securities. Below are some of the key takeaways and unique issues from these settlements.

A. Ability to Pay

The most obvious reason for the discrepancy in the settlement amounts between the two litigations is the defendants' ability to pay the class. The Tezos defendants had money – this is supported by publicly filed documents, the XTZ trading price, and, likely, information divulged during discovery and mediation. In the ATB case, both parties told the court that the defendants were incapable of paying a substantial settlement amount.

B. Foreign Defendants Jurisdiction and Collection

In both actions, several of the foreign defendants raised lack of personal jurisdiction as a defense. In the Tezos case, the Swiss firm was successful in obtaining dismissal, whereas in the ATB case, the individual defendants were not. Given that most ICOs begin abroad, it is likely this type of defense will continue to be raised as an impediment to holding individuals resident in foreign jurisdictions subject to U.S. courts.

In addition, having foreign defendants makes discovery more difficult and more expensive. Many foreign countries have more onerous discovery rules than those of the United States. In China, for example, a citizen may not give a deposition on Chinese soil without certain government authorization. Document collections are also more difficult due to certain legal restrictions, including privacy laws, that are inapplicable in the United States. These factors influence settlement because the domestic class action attorney—who is often working on contingency (as is the case in ATB) may be more hesitant to expend the resources needed to conduct effective discovery.

Finally, and importantly, having foreign defendants means that, even if the parties go through discovery and trial, and even if the class "succeeds," enforcing that judgment can be very difficult. In many jurisdictions there are foreign laws that hinder the recognition and collection of an American judgment.

C. Scope of the Class and Ascertainability

The scope of the proposed classes in the Tezos and ATB cases may have also factored into their different outcomes. The Tezos plaintiffs had already separately moved for class certification. Because the certification motion had not yet been decided, plaintiffs also moved for certification for the purpose of settlement. In both of these detailed motions, the Tezos class was defined as all persons who contributed bitcoin or ether to the Tezos ICO conducted between July 1, 2017 and July 13, 2017. Thus, both U.S. and non-U.S. investors were included in the class.

The ATB plaintiffs never moved for certification prior to filing settlement papers. Only at that point did they request preliminary certification for settlement purposes. Similar to the Tezos class, the ATB class was defined as all persons who acquired ATB tokens during the ATB ICO. Unlike Tezos, however, the scope of the class members was narrowed to those who made their transactions "while located within the United States at the time of their transaction."^[5] In other words, apparently, only investors located in the United States would be deemed class members.

Yet in requesting preliminary class certification, the ATB plaintiffs stated that the class would be ascertained through receipts of purchase (such as email confirmations and cryptocurrency wallet records), which could then be cross referenced by the relevant blockchains. Similar means have been accepted by at least one other court as an adequate means of ascertaining class members who were defined by their purchase of tokens.^[6] However, while purchase

receipts and blockchain confirmation may evidence whether the purchase of an ATB token occurred, it is unclear how it could evidence the location of the purchaser at the time the transaction was made.

D. Procedural Context and iscovery on “Security” Issue

The difference in the procedural settings of the Tezos and ATB cases is also significant in understanding the discrepancy in ultimate proposed settlement amounts. Tezos had been through discovery and two mediations. This means the parties had more transparency into the strengths and weaknesses of their respective cases, such as on the strength of proving whether or not the Tezos token was a “security.” The ATB parties did not conduct substantial discovery. While the ATB plaintiffs succeeded on their motion to dismiss (where the court is required to accept their allegations as true), there was far less factual development as to the actual validity of their registration violation claims. And again, there was more uncertainty as to whether the ATB defendants had the finances to pay out a significant settlement, and whether any settlement could actually be collected.

III. Conclusion

ICOs have mostly vanished from the capital raising playbook over the past two years, and the federal one-year statute of limitations for registration violations will likely limit ICO class actions in the future based solely on Section 5 violations. However, there are still a number of such cases active on court dockets, and the Tezos and ATB cases can provide useful guidance on unique issues that ICO litigation against mostly foreign defendants raise, and how they may be resolved.

The Tezos defendants decided to settle for a relatively significant sum, once their motion to dismiss for lack of personal jurisdiction was denied, rather than face the uncertainty of a greater judgment against them. Though they did preserve the right to claim the Tezos token was not a “security.” Ultimately, though, the remaining defendants settled because they found themselves in the difficult but familiar terrain of an unsuccessful motion to dismiss, limited discovery, and a likely finding of class certification.

The ATB plaintiffs decided that any settlement was better than no settlement, once they were successful in defeating the motion to dismiss. The defendants’ financial condition weighed heavily in favor of that decision. This outcome is common in the long history of securities class cases involving defendants that lack insurance (as the ATB defendants apparently did) and that turn out to have negligible finances. But that’s not the end of the analysis. Upon a closer look, the Tezos and ATB cases can show parties in ongoing ICO class actions that less obvious, and less traditional, defenses and issues, which are specific to the nature of ICOs and blockchain technology, may well be the difference between a significant settlement and a trivial one.

*Authorship Credit: Marc D. Powers and Joanna F. Wasick**

[1] The ICO raised 65,681 bitcoin and 361,122 ether.

[2] For an in-depth analysis of the decision, see Marc D. Powers and Jonathan A. Forman, “Hard for ICOs to Avoid US Courts: Personal Jurisdiction Found in Two Recent Securities Cases over Foreign ICO Defendants.” (Oct. 5, 2018), *available at*: <https://timestampmag.com/2018/10/05/hard-for-icos-to-avoid-us-courts-personal-jurisdiction-found-in-two-recent-securities-cases-over-foreign-ico-defendants/>; Marc D. Powers, *et al.*, “ICOs Avoiding U.S. Citizens Not Immune to Lawsuits in U.S.,” (June 1, 2018), *available at*: <http://blocktribune.com/icos-avoiding-us-citizens-not-immune-to-lawsuits-in-us/>.

[3] See Tezos Annual Report (March 2020), *available at* <https://tezos.foundation/wp-content/uploads/2020/03/tezos-foundation-biannual-update-march-2020.pdf>.

[4] *Morrison v. Nat’l Austl. Bank Ltd.*, 561 U.S. 247, 267, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010)). In *Morrison*, the Supreme Court held that Section 10(b), the general antifraud provision of the Securities Act of 1934, does not apply extraterritorially in a private cause of action involving foreign parties with a foreign securities transaction.

[5] *Balestra v. ATBCOIN LLC*, No. 1:17-cv-1001, Stipulation of Settlement (Apr. 10, 2020), ¶ 1(e), ECF 66-1.

[6] See *Audet v. Fraser*, 332 F.R.D. 53 (D. Conn. 2019).

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