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INTERNATIONAL CRIMINAL LAW AND ENFORCEMENT

Expert Analysis

New Focus on Cryptocurrency, Familiar Questions of Jurisdiction and Territoriality

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It is hard to follow the news these days without hearing talk of cryptocurrencies and the ever-increasing regulatory focus on virtual markets. The Securities and Exchange Commission (SEC)'s new Cyber Unit, for one, has made violations involving distributed ledger technology and initial coin offerings (ICO) a top priority. An ICO is used to raise funds for a venture in exchange for a digital asset called a "token" or "coin." The SEC has already targeted various ICO issuers for investigation or enforcement action, including PlexCorps, a Quebec company charged with its principals in the Cyber Unit's first enforcement action this past December. (The defendants also have been subject to legal action by Quebec authorities.)

In an Eastern District action, the SEC charged PlexCorps, Dominic Lacroix, and Sabrina Paradis-Royer with various violations of the registration and anti-fraud provisions of the securities laws. *SEC v. PlexCorps et al.*, 17 CV 7007 (CBA) (alleging claims under §5(a), 5(c), and 17(a) of Securities Act, and §10(b) of the Exchange Act). The SEC alleged that the defendants misappropriated approximately $15 million in investor funds through an unregistered ICO of "PlexCoin" or "Plex Coin Tokens" that relied on materially false and misleading statements—including promising returns of 1,354 percent in under 29 days. The SEC obtained an order to show cause, temporary restraining order, and asset-freezing order against all defendants. A preliminary injunction was entered against PlexCorps shortly thereafter, with the individual defendants' preliminary injunction hearing deferred on consent.

In the meantime, Lacroix and Paradis-Royer—both Canadian residents—made known their plans to move to dismiss the case under Federal Rules of Civil Procedure 12(b)(2), for lack of personal jurisdiction, and 12(b)(6), for failure to state a claim. They contend that "the SEC has engaged in a tremendous overreach, toward persons who are not subject to personal jurisdiction in this judicial district, and toward transactions that are excluded from regulation under U.S. federal securities laws under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010)." Id. (Dkt. 27). These challenges represent an early test of U.S. regulators' reach over foreign

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Personal Jurisdiction

In a pre-motion letter and conference, Lacroix and Paradis-Royer disputed the notion that they directed their activities toward the United States, noting that they are Canadian residents, were working in Canada, and are not alleged to have "ever set foot in the United States, or had a single discussion, phone call, email, or text message directly with any person in the United States in connection with their efforts." Id. (Dkt. 27). Moreover, they contend that they affirmatively sought to exclude U.S. persons from participating in PlexCoin transactions by requiring potential investors to certify that they are not U.S. persons and to agree to a Terms of Service agreement along the same lines.

The SEC alleged that over 1,500 PlexCoin transactions occurred with investors in the United States and contends this is enough to establish personal jurisdiction. The SEC further contends that defendants did, in fact, take "many specific acts with foreseeable consequences in the United States," including creating Facebook pages and websites about the PlexCoin ICO that were accessible to potential investors in the United States. Id. (Dkt. 30). The Commission also alleges that the defendants marketed and sold PlexCoin in U.S. dollars, and used U.S.-

based entities, like PayPal, Square, and Stripe, to process and retrieve payments.

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The PlexCorps court has signaled a particular interest in how allegedly using such services affects personal jurisdiction, in light of authority suggesting that use of a forum's banking system as an integral part of alleged wrongful conduct may expose users to suit there. Id. (Jan. 8, 2018 Minute Order) (citing inter alia, *Licci ex rel. Licci v. Lebanese Can. Bank, SAL*, 732 F.3d 161, 172 n.7 (2d Cir. 2013)). The defendants have noted, however, that such payment processing services have evolved into international companies and are available for transactions from customers around the globe.

Following the pre-motion conference, the court agreed to permit limited jurisdictional discovery in advance of the 12(b)(2) motion, which will be fully briefed in June. That discovery itself has been contested. The defendants objected to the breadth of the discovery requests as extending beyond contact with the United States and expressed concerns about the impact of depositions on their Canadian legal proceedings. The SEC moved for issuance of letters rogatory for a Quebec court to order documents and testimony from the defendants and third parties and later sought leave to move for discovery sanctions and strike the personal jurisdiction defense. Additional proceedings on the discovery issues followed, with the deadline looming.

Extraterritorial Application

As the personal jurisdiction fight continues, other disputes lurk down the road, should the currently deferred 12(b)(6) motion be filed—namely, whether U.S. securities laws apply to transactions like PlexCoin at all. The SEC called PlexCoin "securities" in the Complaint, but the defendants deem a "major area of dispute" to be whether PlexCoin actually is a "security"—they say it is not. In July 2017, the SEC made public an investigative report in which it determined that digital tokens issued by another organization (The DAO) were securities and advised those who use "distributed ledger or blockchain-enabled means for capital raising, to take appropriate steps to ensure compliance with U.S. federal securities laws," including registration requirements.

SEC Release No. 81207/July 25, 2017. It remains to be seen whether the SEC's view would be confirmed as to PlexCoin.

Even if it is, the defendants' premotion letter argues that PlexCoin transactions were not "domestic transactions" within the meaning of *Morrison.* In *Morrison*, the Supreme Court applied the presumption against extraterritorial application of U.S. laws and held that §10(b) of the Exchange Act applies only to "transactions in securities listed on domestic exchanges" or "domestic transactions in other securities." 561 U.S. at 267. Under *Morrison* and its progeny, a transaction is "domestic," where, inter alia, a party incurs "irrevocable liability" within the United States to "take and pay for a security" or to "deliver a security." *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68 (2d Cir. 2012).

Defendants note that the "sellers" were in Canada, and that "the entities that allegedly received funds from the United States were non-U.S. entities." Moreover, several types of funds used to purchase PlexCoin—bitcoin, ethereum, or litecoin—are "decentralized cryptocurrencies with no fixed U.S. locus." They add that PlexCoin was "developed abroad, built on a decentralized internet exchange protocol with no U.S. locus, and was issued from computers located outside the U.S." Under these circumstances, they contend that no "irrevocable liability" was incurred in the United States and U.S. residents' alleged participation is insufficient. (Dkt. 27). The SEC maintains, by contrast, that electronic communications into PlexCoin's sales system from U.S. billing addresses satisfy *Morrison.* (Dkt. 30) (citing *United States v. Vilar*, 729 F.3d 63, 77-78 n.11 (2d Cir. 2013); Uniform Electronic Transactions Act §15(d)).

The SEC further asserts that §929P(b) of the Dodd-Frank Act restored the so-called "conduct and effects" test that *Morrison* rejected, and supplies an alternative basis for applying U.S. securities law to the PlexCoin transactions. Id. (citing *SEC v. Traffic Monsoon,* 245 F. Supp. 3d 1275 (D. Ut. 2017)). That section provides U.S. courts "jurisdiction" of SEC and government actions under, inter alia, §17(a) of the Securities Act and §10(b) of the Exchange Act that involve "(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States." 124 Stat. 1376, 1864-65 (2010).

Notably, *Morrison* emphasized that the reach of §10(b) is a merits question, not a jurisdictional one. 561 U.S. at 254. Section 929P(b), by contrast, explicitly addresses jurisdiction but not necessarily the applicability of U.S. securities laws to foreign transactions. Noting this distinction, the only apparent decision to have considered the question held that §929P(b)—enacted post-*Morrison*—essentially rebutted the presumption against extraterritoriality, and thus §§10(b) and 17(a) could be applied to foreign transactions. *Traffic Monsoon,* 245 F.3d at 1292-94. The decision was appealed to the Tenth Circuit, which held oral argument at the end of March. Meanwhile, the PlexCorps court has also questioned how far §929P would go, even if it can be deemed to effectively supersede *Morrison,* and whether it would apply to all the alleged securities claims—both registration and anti-fraud violations.

Conclusion

As regulators increase their scrutiny of virtual currency markets, other foreign issuers, like PlexCorps, are likely to come into their crosshairs. What actions such players take to make, or avoid, contact with the United States and whether it is enough for personal jurisdiction will continue to evolve. Similarly, the ability of U.S. securities laws to reach these marketplaces at all will be further tested as the case law develops in the near future.

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