# Blockchain Law

# Out to sea? Extraterritoriality challenges in US crypto litigation

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**In his Blockchain Law column, Robert Schwinger raises the question: "How far is too far when it comes to litigating crypto in the United State?"**

For crypto enthusiasts, one of the burgeoning technology's great appeals is its international reach. For litigants, though, one of its great hurdles may be that same international reach. The U.S. Court of Appeals for the Second Circuit's recent non-precedential summary order in *Barron v. Helbiz*, 2021 WL 4519887 (2d Cir. Oct. 4, 2021), grapples with this point and addresses some of the challenges that can be made on extraterritoriality grounds to applying U.S. federal and state law in the cryptocurrency context. How far is too far when it comes to litigating crypto in the United States?

## Spanning the globe

Blockchain and other distributed-ledger technology continue to play an increasingly active role in global commerce and finance, with increasing sophistication. Smart contract technology can enable parties around the world to bind one another to agreements and record their cross-border transactions efficiently and transparently, fostering trust and liquidity in the marketplace. Initial coin offerings (ICOs) invite individuals around the globe—including sometimes in the United States—to invest in new and innovative digital currencies, possibly even expanding access to credit and capital without regard to one's geographic location. And all this is largely possible with nothing more than an internet connection. The systems underlying this activity not infrequently involve a raft of connections among individuals, companies, legal instruments and structures, and computer servers that may be based in any number of different countries.

But things don't always go as planned, and this may lead to litigation. For litigants who then seek to obtain legal relief in the United States under domestic law, what does the globalized nature of crypto activity mean for their ability to do so?

Litigators are familiar with questions of personal jurisdiction (whether it is fair and reasonable to subject a defendant to litigation in a particular forum) and conflicts of law (how to resolve which jurisdiction's law is the most appropriate to provide the rule of decision for judging a dispute). But in globalized contexts, another issue—extraterritoriality—

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raises the question of whether or when local law is in fact meant to apply to litigants or activity outside the forum's territorial jurisdiction.

How does this consideration come into play for the kinds of claims that may get raised in domestic cryptocurrency litigation? What framework will courts apply when analyzing objections based on extraterritoriality, and what facts might affect whether claims under U.S. federal or state law will survive such objections?

## The 'Morrison' framework for extraterritoriality

Contemporary discussions of extraterritoriality frequently start with the United States Supreme Court's 2010 decision in *Morrison v. National Australia Bank Ltd*., 561 U.S. 247 (2010). That decision analyzed whether and to what extent Section 10(b) of the Securities Exchange Act of 1934 applied to conduct outside the United States.

Morrison began by citing the "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'" Id. at 255 (quoting *E.E.O.C. v. Arabian Amer. Oil Co*., 499 U.S. 244, 248 (1991)).

The court first concluded that nothing in the text or structure of Section 10(b) overcame that so-called presumption against extraterritoriality. It then analyzed Section 10(b) to determine what specific conduct constituted the statute's "focus," in order to assess whether the facts as alleged in the plaintiff's complaint involved a permissible domestic application or an impermissible extraterritorial application of Section 10(b). It held that "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States."

Because *Morrison* involved foreign plaintiffs seeking to recover investment losses relating to foreign-issued securities traded on foreign exchanges (commonly referred to as "F-cubed" claims), the court held their attempted §10(b) claim barred by extraterritoriality limitations.

A few years later, the Supreme Court applied *Morrison* in *Kiobel v. Royal Dutch Petroleum Co*., 569 U.S. 108 (2013), to dismiss claims asserted under the Alien Tort Statute (ATS). Those claims had been brought by U.S.-resident Nigerian nationals, who alleged that various defendant foreign corporations had aided and abetted the Nigerian Government in committing violations of the law of nations in Nigeria.

Applying *Morrison*, the court dismissed the claim on extraterritoriality grounds. The ATS claim was raised by foreign plaintiffs against foreign defendants for foreign conduct (another "F-cubed" scenario), and the fact that the corporate defendants might also have some presence in the United States was held insufficient to "displace the presumption against extraterritorial application" of the U.S. statute.

The Supreme Court further clarified its thinking on extraterritoriality in *RJR Nabisco v. European Community*, 579 U.S. 325 (2016). It stated that "*Morrison and Kiobel* reflect a two-step framework for analyzing extraterritoriality issues."

The first step is to determine "whether the presumption against extraterritoriality has been rebutted—that is, whether the statute gives a clear, affirmative indication that it applies extraterritorially." If not, then in the second step the court must "determine whether the case involves a domestic application of the statute," which is done "by looking to the statute's 'focus,'" namely:

> If the conduct relevant to the statute's focus occurred in the United States, then the case involves a permissible domestic application even if other conduct occurred abroad; but if the conduct relevant to the focus occurred in a foreign country, then the case involves an impermissible extraterritorial application regardless of any other conduct that occurred in U.S. territory.

*RJR Nabisco* also clarified that the presumption against extraterritoriality it applied was "a canon of statutory construction." In other words, the court applied the presumption because it was interpreting a federal statute; it did not purport to ground its holding on constitutional grounds such as due process considerations.

## Taking 'Morrison' too far

In *Helbiz*, the Second Circuit issued a summary order vacating the district court's dismissal of a class-action complaint seeking relief from an alleged pump-and-dump scheme involving issuance of a new cryptocurrency. The court held that while the *Morrison* framework is well-settled, it does not automatically apply when state statutory and common-law causes of action, as opposed to federal statutory claims, are involved.

The plaintiffs in *Helbiz* were "purchasers of HelbizCoin, a cryptocurrency that plaintiffs allege was created, marketed, issued and controlled by Helbiz (a Delaware corporation) and Salvatore Palella." Plaintiffs alleged that Helbiz and Palella marketed HelbizCoin as the future "exclusive currency of a smartphone-based transportation rental platform to be developed by Helbiz." In a familiar scenario for ICOs, the HelbizCoin ICO was pitched as both necessary to raising the capital to build and market the new rental platform and a unique opportunity to invest in the future platform's native digital currency.

Plaintiffs alleged, though, that after the ICO "Helbiz and Palella reneged on a number of the promises" made to investors, "including the promise to use HelbizCoin as the platform's exclusive currency." Plaintiffs further allege "that Helbiz and Palella kept the money raised in the ICO for themselves instead of using the funds to build the rental platform," which ultimately "caused the price of HelbizCoin to plummet."

The plaintiffs did not allege statutory claims under the federal securities laws, however. Rather, proceeding in federal court solely on the basis of diversity, they raised only New York common-law claims (breach of contract, trespass and conversion of chattels, constructive trust, quieting of title, spoliation) and claims under New York state and city statutes.

Despite this, "[t]he district court, *sua sponte*, requested briefing from the parties to address whether plaintiffs' complaint was subject to dismissal under *Morrison*." Faced with evidence from the defendants "apparently showing that HelbizCoin was created and issued abroad by a Singaporean third party unaffiliated with Helbiz, and that U.S. citizens were prohibited from purchasing HelbizCoin," the district court analyzed the claims under *Morrison* and dismissed on the basis that the case involved neither securities listed on a domestic exchange nor domestic purchases of securities.

Plaintiffs argued on appeal that it was error to dismiss their purely state-law claims (most of which were nonstatutory) under *Morrison*, a decision that applied canons of statutory construction to construe a federal statute. The Second Circuit agreed and reversed in a summary order.

The court concluded it was "not a fair reading of the complaint" for defendants to assert that, "though labeled as state law claims, all of plaintiffs' claims are substantively federal securities claims for fraud brought under Section 10(b)." *Morrison* "did not assert that its analysis applied to claims that are not brought under Section 10(b) of the Securities Exchange Act, such as the state law claims made here."

Even so, the Second Circuit noted that this was not the end of the analysis. It noted that "[w]hile plaintiffs' various claims might eventually fail for lacking adequate domesticity, that determination must be made pursuant to a more tailored approach that analyzes any Section 10(b) claims under *Morrison*, and separately, any state law claims under New York's rules for the extraterritorial application of its law." The Second Circuit thus remanded the case back to the district court for further proceedings.

## State-law extraterritoriality rules?

The Second Circuit did not perform any analysis under the rules for assessing the extraterritoriality of New York state law, and instead left that for the district court to address on remand. But the court did cite to a passage in *Global Reins. Corp.-U.S. Branch v. Equitas Ltd.*, 18 N.Y.3d 722, 735 (2012), where the New York Court of Appeals explained that "[t]he established presumption is, of course, against the extraterritorial operation of New York law, and we do not see how it could be overcome in a situation where the analogue federal claim would be barred by congressional enactment."

While it therefore may be that the assertions of extraterritoriality against state-law claims will ultimately be assessed under a rubric similar to *Morrison* (at least in New York), it may not be that simple. As the *Helbiz* plaintiffs noted in their appellate briefing, the Second Circuit recently stated in *City of New York v. Chevron*, 993 F.3d 81, 101 (2d Cir. 2021), that "it is unsettled whether the presumption against extraterritoriality—a canon of statutory interpretation—applies to common law rules."

They further cited a New York state-court decision reasoning that "New York courts have historically found that there is no territorial limit to New York common law causes of action, as there is with federal and state statutes." *Norex Petroleum Ltd. v. Blavatnik*, 48 Misc.3d 1226(A) (Sup. Ct. N.Y. Co. 2015) (collecting cases), aff'd, 151 A.D.3d 647 (1st Dep't 2017).

In fact, there appears to be significant variation among states regarding whether they impose any presumptions regarding the extraterritorial effect of their statutes. See, e.g., William S. Dodge, "Presumptions Against Extraterritoriality in State Law", 53 U. Cal. Davis L. Rev. 1389, 1403-04 (2020) (surveying the states). The Fourteenth Amendment and international law may furnish additional bases for limiting extraterritorial application of state laws. See id. at 1392.

Whether or not there are extraterritoriality limitations on the ability to assert state statutory or common-law claims in the international context, it still may well be that comity, forum non conveniens, or other prudential doctrines could be brought to bear in crypto litigation involving conduct and parties in multiple jurisdictions. But at the very least, the non-precedential ruling in *Helbiz* suggests that litigants ought not assume that *Morrison* will govern the entire analysis of this area.

Parties in cryptocurrency litigation will therefore need to investigate, potentially on a claim-by-claim basis, application of the federal extraterritoriality framework under *Morrison* and how a given state approaches the extraterritoriality concerns with respect to causes of action asserted under its statutes and common law.

## Factual complexity in crypto litigation

Assuming there are extraterritoriality limits to be considered—whether via *Morrison* or some other framework—the question then becomes whether a plaintiff's allegations entail an impermissible extraterritorial application of particular laws. In the complex global environment of cryptocurrency transactions and operations, that can be a very fact-intensive inquiry, as shown by the extraterritoriality analysis performed by a district court in *In re Tezos Sec. Litig.*, 2018 WL 4293341 (N.D. Cal. Aug. 7, 2018), under the *Morrison* framework.

In *Tezos*, the lead plaintiff alleged that individuals located in California had designed a new cryptocurrency that was supposed to overcome asserted shortcomings of other digital currencies, such as Bitcoin. Eventually, the defendants conducted an ICO in which investors paid millions of dollars' worth of Bitcoin and Ethereum to obtain the new Tezos tokens. The Tezos ICO was never registered under United States securities laws.

*Tezos* involved a number of actors in a number of jurisdictions. The lead plaintiff was an Illinois resident, who contributed 250 Ethereum coins to the ICO. He sought rescission of his purchase under Section 12 of the Securities Exchange Act of 1934 and sought additional relief under Section 15 against defendants alleged to be "control persons" for the relevant transactions.

Tezos purchasers bought their tokens from the Tezos Foundation, an entity founded by the two individual California defendants. The Tezos Foundation was thus the primary defendant for the Section 12 claim. The Tezos Foundation, however, was based in the Channel Islands and governed by Swiss law.

A provision within the "contribution terms" drafted by the Foundation (which oddly were neither included nor linked to in any of the Foundation's English-language websites) purported to make Europe "the legal situs of all ICO-related participation and litigation" for Tezos. The terms stated that "[t]he contribution software and the client are located in Alderney. Consequently, the contribution procedure ... is considered to be executed in Alderney." The terms further provided that "[t]he applicable law is Swiss law" and "[a]ny dispute...shall be exclusively and finally settled in the courts of Zug, Switzerland."

Also named in the lawsuit were a Swiss bank, over which party the court concluded it lacked personal jurisdiction, and a high-profile investor from the United States, who helped promote the Tezos ICO.

The Tezos Foundation argued that plaintiffs' Section 12 claims could not reach the Foundation's alleged conduct because the statute does not apply extraterritorially. Pointing to *Morrison*, the Foundation contended that "any transaction taking place with [the plaintiff] could only have occurred in Alderney," as Alderney had been "specified as the legal site of all ICO transactions by the Contribution Terms."

Moreover, the Foundation argued, even if the Contribution Terms were deemed not to apply, the Court should look to where any ICO-related transfer of title or instance of "irrevocable liability" took place, as these factors had been identified as "touchstones of the domestic transaction inquiry" by New York and California federal appellate courts after *Morrison*. Under those tests, the Foundation insisted, the sale location should be deemed "confined to Alderney, where the Foundation's 'contribution software' resides."

The district court disagreed. While conceding the Foundation was "generally correct as to the scope of federal securities law," it held that the Foundation's "reliance on the validity of the contribution terms" was unavailing because the court, at least at the dismissal stage, had already determined there were sufficient facts alleged in the complaint to infer that the plaintiff had not been given sufficient notice of the contribution terms.

Accordingly, the court reasoned that it was necessary to determine "the actual (rather than contractual) situs of ICO transactions."

Under this approach, said the court, "the operative question quickly surfaces: where does an unregistered security, purchased on the Internet, and recorded 'on the blockchain,' actually take place?" The court's exploration of this question offers some insight into what kind of facts a crypto litigation plaintiff could plead that would avoid suggesting that it was requesting extraterritorial application of U.S. law to a crypto transaction. While the formulation of the court's question was phrased in the context of the ICO at issue in *Tezos*, it reflects the difficulty and complexity of identifying domesticity in almost any kind of crypto transaction.

In *Tezos*, several factors led the court to the conclusion that sufficient relevant conduct occurred in the United States for the case to be properly viewed as domestic application of Sections 12 and 15 of the Exchange Act. "Try as the Foundation might to argue that all critical aspects of the sale occurred outside of the United States," said the court, "the realities of the transaction (at least as alleged by [the plaintiff]) belie this conclusion." It identified as supporting this finding the allegations that that the plaintiff:

- "participated in the transaction from this country";
- "did so by using an interactive website that was: (a) hosted on a server in Arizona; and (b) run primarily by [one of the California-based individual defendants] in California";
- "presumably learned about the ICO and participated in response to marketing that almost exclusively targeted United States residents"; and
- made a "contribution of Ethereum to the ICO [that] became irrevocable only after it was validated by a network of global 'nodes' clustered more densely in the United States than in any other country."

The court noted that "no single one of these factors is dispositive," but concluded that "together they support an inference that [the plaintiffs] alleged securities purchase occurred inside the United States." Thus, "proceeding with all due consideration of the limited reach of this nation's laws," the Court concluded that "application of the Exchange Act does not offend the mandate of *Morrison*." The court thus denied the motion to dismiss based on extraterritoriality.

*Tezos* shows that when limits on extraterritoriality come into play—whether via *Morrison* or otherwise—a pleading's factual content matters greatly. Attempts to avoid the reach of U.S. law by centering blockchain transactions in non-U.S. jurisdictions may not be successful where key parties or platforms involved reside or are hosted in the United States, or where the underlying marketing had been directed at the United States, or where there is reason to believe the validating of the relevant blockchain transactions was densely clustered in the United States.

The facts thus matter, and apparently at a granular level. Even if on the surface it may appear that a given crypto transaction is beyond the reach of United States law, further investigation may reveal sufficient domesticity.

## Conclusion

The complex cross-border environment in which cryptocurrency and other blockchain applications operate presents ample opportunity for parties to object to litigation within the United States on the basis of extraterritoriality limitations. As *Helbiz* shows, though, there may be no simple "one size fits all" analysis for such objections. Under *Morrison*, each federal statute requires its own specific analysis. State-law claims may be analyzed differently from the analysis of federal law claims under Morrison, and state-law claims themselves may be analyzed differently depending on whether they are statutory or common-law in nature.

Even once the governing analytical framework is identified, *Tezos* shows that the age-old litigator's maxim rings true once more: ultimately the facts matter. Plaintiffs crafting complaints and parties litigating motions to dismiss will need to dig deep into the often messy facts of complex cross-border systems and transactions—including which domestic and foreign persons were involved with which aspects of those systems and transactions and where—to determine whether sufficient domesticity can be shown to overcome extraterritoriality objections. Sufficient domesticity may prove to be present despite the involvement of multiple foreign parties and the surface appearance of primarily foreign conduct.

When it comes to extraterritoriality, litigants thus may have to battle fiercely to ensure that their claims in U.S. state and federal courts are not improperly swept out to sea.



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