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World's Largest Cryptocurrency Exchange Wins Dismissal of Class-Action Lawsuit

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On March 31, a New York federal court dismissed a proposed securities class-action lawsuit filed against Binance, the world's largest cryptocurrency exchange. The lawsuit, one of a host of similar actions brought against cryptocurrency exchanges in 2020, was filed by token buyers who purchased cryptocurrency on Binance's platform.

The plaintiffs asserted that Binance had violated two securities statutes, the Securities Act of 1934 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act). The Securities Act prohibits the sale of unregistered securities, while the Exchange Act requires securities issuers to make certain disclosures so investors can make informed investment decisions. On April 3, 2019, the Securities Exchange Commission (SEC), released an assessment strategy, "Framework for 'Investment Contract' Analysis of Digital Assets" (Framework), which identified the factors for determining whether a digital asset, like cryptocurrency, is an "investment contract" and therefore subject to the Securities Act and the Exchange Act. An "investment contract," as defined by the U.S. Supreme Court, exists when there is investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 294 (1946). This definition applies to any contract, scheme, or transaction, regardless of whether it possesses any of the characteristics of typical securities.

The plaintiffs contended that Binance violated the Securities Act and the Exchange Act by failing to file a registration statement with the SEC for the tokens it sold and by failing to inform token buyers that their investments were securities rather than digital assets. However, the court did not reach these questions, instead dismissing the lawsuit for untimeliness and extraterritoriality.

1. Untimeliness

The parties agreed that Binance's latest potential violation of the Securities Act and the Exchange Act occurred in February 2019. However, the plaintiffs did not sue Binance until September 2020, more than one year later. This means that plaintiffs had exceeded the one-year window for filing suit under both statutes. As the court explained, the clock began ticking on the statutory one-year window the moment a violation occurred, not when the plaintiffs learned about the violation. The court also explained that the SEC's release of the Framework in April 2019 did not stop the clock from running, and thereby extend the one-year window because the Framework did not reveal any new facts about the case, it simply made the plaintiffs aware of the Supreme Court's definition of an "investment contract."

2. Extraterritoriality

The court also dismissed the lawsuit because of Binance's extraterritoriality, or because it was not "domiciled" in the United States, and therefore not governed by U.S. law. Binance's corporate domicile is currently unknown, as the company maintains no physical corporate headquarters. It does use U.S.-based computer servers, but this and the plaintiffs' access of Binance's platform from the United States were both too attenuated to subject Binance to U.S. securities laws.

Our Take

This case provides a snapshot of the tensions resulting from applying preexisting regulations to the digital asset industry. Investors and issuers of digital assets alike are presently attempting to conscientiously navigate the intricacies of an unconfined, rapidly evolving market that was recently legitimized by President Joe Biden's March 9 executive order. Given these developments, we anticipate that courts will face more cases raising issues like the Binance case that examine the applicability of federal securities laws and regulations in the digital asset realm.

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