

Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: SEC's request for injunction against Telegram granted, (Mar. 25, 2020)

Securities Regulation Daily Wrap Up

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By [Amy Leisinger, J.D.](#)

The Commission has sufficiently shown that Telegram's plan to distribute Grams involves a securities offering under the *Howey* test to which no exemption applies.

The Southern District of New York has granted the SEC's request for a preliminary injunction against Telegram Group prohibiting the delivery of its tokens (Grams) to initial purchasers in violation of registration provisions of the federal securities laws. According to the court, Gram purchasers possessed a reasonable expectation of profit based upon the efforts of Telegram in terms of gains from the resale of the tokens in the post-launch period. Under the test set forth in *SEC v. W.J. Howey Co.*, the SEC has sufficiently alleged that the series of contracts and understandings related to Grams are securities, the court found ([SEC v. Telegram Group Inc.](#), March 24, 2020, Castel, K.).

Ongoing litigation. In January 2018, Telegram began to raise capital to launch a blockchain called the "Telegram Open Network" or "TON," which would host new cryptocurrencies and decentralized applications on a large scale. Telegram raised \$1.7 billion from over 170 initial purchasers via agreements for the purchase of digital-asset securities called Grams, which would be created upon the launch of TON. Telegram had committed to deliver the Grams to purchasers in conjunction with TON's launch on October 31, 2019. Upon delivery, purchasers would then be able to resell the Grams on the open market.

The Commission [alleges](#) that Grams were securities being sold in violation of the registration provisions of the Securities Act and obtained a temporary restraining order ahead of the promised delivery date. The SEC also states that the initial purchasers are "underwriters" who will engage in a distribution of Grams into a public market that will not have the information that a registration statement would provide. In response, Telegram [argues](#) that its digital tokens are not securities and contends that the agreements to sell Grams are private placements covered by a registration exemption.

Injunction granted. The court noted that, in order to obtain a preliminary injunction, the SEC must make a substantial showing of the likelihood of success in proving a violation and of a risk of future harm without an injunction. The court explained that the SEC has shown proof that the contracts and understandings involving the sale of Grams to the initial purchasers are part of a larger scheme to distribute the tokens into a secondary public market. "[T]he resale of Grams into the secondary public market would be an integral part of the sale of securities without a required registration statement," the court stated. Telegram was aware that purchasers would not be willing to spend nearly \$2 billion to acquire Grams just to store or transfer value, according to the court; a reasonable purchaser would have expected to profit only if the reputation, skill, and involvement of Telegram and its founders remained, it stated.

Telegram would be the force behind the TON blockchain for the post-launch period when the initial purchases would be selling Grams into the secondary market, the court explained. To demonstrate a "common enterprise" under the *Howey* test, the SEC has made the required showing of horizontal and vertical commonality with a pooling of assets and investors wealth being tied to Telegram's success, according to the court. In addition, the terms of the Gram purchase agreements point to an investment intent on the part of the initial purchasers, the court stated, and a reasonable person would not agree to freeze millions of dollars for a long period simply to obtain a substitute currency.

As such, under the *Howey* test, the SEC has sufficiently alleged that initial purchasers invested in a common enterprise and possessed a reasonable expectation of profit based upon the efforts of Telegram, the court found. Further, the Commission has demonstrated a substantial likelihood of success in proving that the sales were part of a larger scheme that Grams be distributed in a secondary public market, which is an offering of securities under *Howey*, according to the court. Finding that Telegram failed to establish an exemption to the registration requirement, the court granted the Commission's motion for a preliminary injunction.

The case is [No. 19-cv-9439 \(PKC\)](#).

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Companies: Telegram Group Inc.; TON Issuer Inc.

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