

[Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: SEC sends a message in halting \\$1.7B Telegram token offering, \(Oct. 15, 2019\)](#)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

The Commission obtained a temporary restraining order blocking the delivery of Gram tokens to initial purchasers, which it believes would resell them to the public.

The SEC filed an emergency action to halt a \$1.7 billion unregistered digital token offering. According to the complaint filed in the Southern District of New York, two offshore entities, Telegram Group Inc. and its wholly owned subsidiary TON Issuer Inc., sold 2.9 billion digital tokens worldwide, over a billion of those to 39 U.S. investors. The SEC [obtained](#) a temporary restraining order ahead of the promised October 31 delivery date of the tokens to prevent their resale to the public ([SEC v. Telegram Group Inc.](#), October 11, 2019).

Telegram, which previously launched a successful social network and a widely adopted messaging app, began raising capital in January 2018 to finance the development of the Telegram Open Network blockchain and Telegram Messenger. Telegram raised \$1.7 billion from 171 initial purchasers via agreements for the purchase of Gram tokens. According to the SEC, these initial purchasers are effectively underwriters, and the plan is to resell the tokens to the public.

Securities or currency? Although Telegram acknowledged that the Gram purchase agreements were securities and placed a restrictive legend on those agreements, it takes the position that the Grams themselves are a currency rather than securities. Accordingly, Grams bear no restrictive legends, and only some of them contain lockups restricting their resale. The Commission disagrees with that assessment, however.

[Legislators](#) and [industry groups](#) have asked the SEC to issue specific guidance on cryptocurrency and token offerings, but the agency for the most part has fallen back on its position that the Howey test controls whether any arrangement, including digital assets, is a security. Last June, CorpFin Director William Hinman [said](#) that he believes it is possible for an asset originally offered as a security to be sold later in a manner that does not constitute a securities offering. In his view, it depends on whether holders of the asset have rights akin to financial interests or whether, on the other hand, the asset acts as a token that only allows its holders to buy goods or services.

The Telegram complaint initially appears to set up a catch-22: "Grams are not a currency because they have no realistic currency uses at this time," the SEC writes, but the purpose of the endeavor was to raise money to build the platform on which the tokens could be used. The agency goes further, however, also alleging that Telegram sold more tokens than could ever realistically be used on the TON blockchain. The inclusion of lock-up provisions for some of the tokens evinces Telegram's understanding that initial purchasers would resell their Grams upon delivery. The SEC further alleges that the \$1.7 billion raised in the offering far exceeds the projected cost of developing the blockchain.

Howey factors. Running through the prongs of Howey, the SEC alleges that Grams are securities. Telegram emphasized to investors that the company, its founders, and the Messenger app were integral to the success of the project. Purchasers were led to expect that the defendants would use the offering proceeds to finance their businesses and that they had a stake in those endeavors. Telegram also led investors to expect substantial profits from Telegram's efforts in the common enterprise, according to the SEC. Finally, while the offering documents for the Gram purchase agreements discussed future uses for Grams, none of these potential uses actually existed at any time.

The SEC also alleges that Telegram always intended a public offering of Grams, citing its offering materials. In fact, the agency writes, the offering documents make clear that Telegram understood from the outset that Grams needed to be held by a large number of individuals for the project to take off. In one teaser from the materials, Telegram said that its vision included "an engaged user base that provides preexisting critical mass necessary for the ecosystem to grow and eventually become adopted by hundreds of millions of users."

Telegram is on track to deliver Grams to the initial purchasers, having already released a beta version of the TON blockchain and launched the TON wallet, the SEC alleges. However, the defendants have not prepared a registration statement for distribution to the investing public that will eventually purchase Grams. To prevent this unlawful resale and distribution, the SEC obtained a temporary restraining order and seeks permanent injunctions, along with disgorgement.

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

Attorneys: Jorge Gerardo Tenreiro for the SEC.

Companies: Telegram Group Inc.; TON Issuer Inc.

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