

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

19-cv-9439 (PKC)

-against-

OPINION  
AND ORDER

TELEGRAM GROUP INC. and TON ISSUER  
INC.,

Defendants.  
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CASTEL, U.S.D.J.

The Securities and Exchange Commission (“SEC”) seeks to enjoin Telegram Group Inc. and TON Issuer Inc. (collectively “Telegram”) from engaging in a plan to distribute “Grams,” a new cryptocurrency, in what it considers to be an unregistered offering of securities. In early 2018, Telegram received \$1.7 billion from 175 sophisticated entities and high net-worth individuals in exchange for a promise to deliver 2.9 billion Grams. Telegram contends that the agreements to sell the 2.9 billion Grams are lawful private placements of securities covered by an exemption from the registration requirement. In Telegram’s view, only the agreements with the individual purchasers are securities. Currently, the Grams will not be delivered to these purchasers until the launch of Telegram’s new blockchain, the Telegram Open Network (“TON”) Blockchain. Telegram views the anticipated resales of Grams by the 175 purchasers into a secondary public market via the TON Blockchain as wholly-unrelated transactions and argues they would not be the offering of securities.

The SEC sees things differently. The 175 initial purchasers are, in its view, “underwriters” who, unless Telegram is enjoined from providing them Grams, will soon engage

in a distribution of Grams in the public market, whose participants would have been deprived of the information that a registration statement would reveal.

Cryptocurrencies (sometimes called tokens or digital assets) are a lawful means of storing or transferring value and may fluctuate in value as any commodity would. In the abstract, an investment of money in a cryptocurrency utilized by members of a decentralized community connected via blockchain technology, which itself is administered by this community of users rather than by a common enterprise, is not likely to be deemed a security under the familiar test laid out in S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946). The SEC, for example, does not contend that Bitcoins transferred on the Bitcoin blockchain are securities. The record developed on the motion for a preliminary injunction presents a very different picture.

The Court finds that the SEC has shown a substantial likelihood of success in proving that the contracts and understandings at issue, including the sale of 2.9 billion Grams to 175 purchasers in exchange for \$1.7 billion, are part of a larger scheme to distribute those Grams into a secondary public market, which would be supported by Telegram's ongoing efforts. Considering the economic realities under the Howey test, the Court finds that, in the context of that scheme, the resale of Grams into the secondary public market would be an integral part of the sale of securities without a required registration statement.

Telegram knew and understood that reasonable purchasers would not be willing to pay \$1.7 billion to acquire Grams merely as a means of storing or transferring value. Instead, Telegram developed a scheme to maximize the amount initial purchasers would be willing to pay Telegram by creating a structure to allow these purchasers to maximize the value they receive upon resale in the public markets.

As part of its Howey analysis, the Court finds an implicit (though formally disclaimed) intention on the part of Telegram to remain committed to the success of the TON Blockchain post-launch. Indeed, Telegram, as a matter of fact rather than legal obligation, will be the guiding force behind the TON Blockchain for the immediate post-launch period while the 175 purchasers unload their Grams into the secondary market. As such, the initial 175 purchasers possess a reasonable expectation of profit based upon the efforts of Telegram because these purchasers expect to reap whopping gains from the resale of Grams in the immediate post-launch period. Under the Howey test, the series of contracts and understandings centered on Grams are a security within the meaning of the Securities Act of 1933 (the “Securities Act”).

For reasons that will be more fully explained, the Court finds that the SEC has shown a substantial likelihood of success in proving that Telegram’s present plan to distribute Grams is an offering of securities under the Howey test to which no exemption applies. The motion for a preliminary injunction will be granted.

At the preliminary injunction hearing, neither side offered live testimony, despite an opportunity to do so. (Doc. 58). The parties presented the Court with a fulsome Joint Stipulation of Facts (“Joint Stip.”), (Doc. 72), and each side offered deposition testimony, exhibits, and declarations. The parties also filed cross-motions for summary judgment and the SEC filed a motion to strike an affirmative defense, motions which the Court finds unnecessary to reach at this juncture. Set forth below are the Court’s findings of fact and conclusions of law on the motion for a preliminary injunction.<sup>1</sup>

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<sup>1</sup> Citations to evidence are illustrative only and are not intended to indicate that the cited evidence is the only evidence supporting the finding.

## FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Telegram.

In 2006, Pavel Durov founded VKontakte, a Russian version of Facebook. (Joint Stip. ¶ 9). With the help of Nikolai Durov, his brother and a skilled programmer, Pavel successfully built VKontakte into the largest Russian social media network. (Joint Stip. ¶¶ 11–13). Pavel accumulated a sizeable personal fortune before exiting VKontakte and leaving Russia over disputes with the Russian government. (Plaintiff’s Exhibit (“PX”) 18 at 2 (Doc. 122-18)); (Defs.’ Resp. to Pls.’ Counter-Statement at 51 (Doc. 120)).

In 2013, the Durov brothers founded Telegram and released Telegram Messenger, which remains Telegram’s signature product. (Joint Stip. ¶¶ 16, 23); (Defs.’ 56.1 Statement ¶¶ 42, 45 (Doc. 75)). Telegram is a private company, (Pl.’s 56.1 Statement ¶ 154 (Doc. 80)), and Pavel is its chief executive officer, (Joint Stip. ¶ 3). Messenger is a messaging app that offers end-to-end encryption and also contains a diverse ecosystem of groups, channels, and in-app commerce. (Joint Stip. ¶¶ 18–19, 22); (Doc. 80 at 1); (PX 18 at 7). Messenger is globally popular and currently has a monthly user base of approximately 300 million. (Doc. 75 ¶ 43). Messenger is also particularly popular among the cryptocurrency community and has been described as the “cryptocurrency world’s preferred messaging app.” (Joint Stip. ¶ 23); (Joint Exhibit (“JX”) 8 at 12 (Doc. 72-8)). Telegram was founded with non-profit goals, (JX 8 at 5), and states that Messenger will never charge user fees or introduce advertising on the app, (Joint Stip. ¶ 21). As such, Messenger has never produced any revenues, (PX 18 at 1, 5), and, excluding the present offering of Grams, the Durov brothers have never received any income from their wildly successful creation. (Joint Stip. ¶¶ 14–15).

Messenger generates no revenues; nearly all of Messenger’s expenses prior to 2018, including salaries and server costs, were paid for by Pavel out of his personal fortune. (Joint Stip. ¶ 17); (Doc. 80 ¶ 3). After receiving the \$1.7 billion from the private offering of 2.9 billion Grams, Telegram used this newly raised capital to cover “way over 90 percent” of Telegram’s expenses, which includes the costs of Messenger. (PX 12 at 53:2–3 (Doc. 122-12)); (Doc. 80 ¶ 12); (Malloy Decl., Ex. 4 at 1 (Doc. 167-4)). When describing its projected budgets for 2019 and 2020, which totaled \$180 and \$220 million respectively, Telegram stated that it still lacked plans to generate revenue from Messenger, so would continue to pay Messenger’s way using funds from the offering of Grams and Pavel’s personal wealth for the foreseeable future. (Doc. 80 ¶ 26); (PX 18 at 5, 8). Telegram subsequently reported that, from January 2018 to January 2020, it spent \$405 million, about 24% of the proceeds from the offering of Grams, on the development of the TON Blockchain and the operations of Messenger. (Joint Stip. ¶¶ 144–45).

#### B. The TON Blockchain and Grams.

In 2017, Telegram began development of a proprietary blockchain and digital asset.<sup>2</sup> (Doc. 75 ¶ 49). The Durov brothers believed that Telegram could learn from the mistakes of existing blockchains and, by correcting their flaws, enable Telegram’s new cryptocurrency to be the first to achieve truly widespread adoption. (Doc. 75 ¶¶ 46–48). Telegram’s proposed blockchain would be named the “Telegram Open Network” (“TON”) Blockchain and its native token would be called the “Gram.”<sup>3</sup> (Doc. 75 ¶¶ 49, 52).

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<sup>2</sup> A blockchain serves as the means of validating the authenticity of a transfer of a unit of cryptocurrency. It is a widely distributed but secure ledger or account of transactions. (Doc. 75 ¶¶ 1–3). Individual blockchain transactions are grouped together and then recorded in “blocks” that are linked to prior blocks creating a “chain.” (Doc. 75 ¶¶ 7–8). No centralized master copy of the blockchain exists; instead current versions of the blockchain are kept by individual users connected across a network. (Doc. 75 ¶¶ 9–10); (Waxman Decl. at 1 n.1 (Doc. 16)).

<sup>3</sup> A unit of a cryptocurrency can be used to store and transfer value, provide access to real-world services, offer voting or governance rights within the blockchain, or power applications and smart contracts built into the blockchain.

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