Peter Scoolidge
SCOOLIDGE LLP
315 W. 36th Street
New York, NY 10018
(212) 913-9455
Attorneys for Defendants Hieusys, LLC, Colin LeMahieu, Troy Retzer, and Mica Busch

Shawn Naunton
Vanessa Garcia
ZUCKERMAN SPAEDER LLP
485 Madison Avenue
New York, NY 10022
(212) 704-9600
Attorneys for Defendant Zack Shapiro

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

ALEX BROLA, individually; and on behalf of All Others Similarly Situated; *Plaintiff*, v. NANO f/k/a RAIBLOCKS f/k/a HIEUSYS, LLC, a Texas company; COLIN LEMAHIEU, an individual; MICA BUSCH, and individual; ZACH SHAPIRO, an individual; and TROY RETZER, an individual; *Defendants*.	§	Case Number: 1:18-cv-02049

MEMORANDUM OF LAW IN SUPPORT OF
DEFENDANTS' MOTION TO DISMISS THE COMPLAINT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Treatises

INTRODUCTION

Plaintiff Alex Brola alleges that in December 2017, he sent $50,000 to the BitGrail cryptocurrency exchange in Florence, Italy, to buy a cryptocurrency known as Nano. Mr. Brola has not alleged that he had any contact or business dealings with the Defendants prior to his purchase. Following Mr. Brola's purchase, BitGrail was the target of a hack that depleted its accounts and allegedly resulted in a loss to Mr. Brola of the entire value of his Nano holdings. Rather than bring an action against BitGrail and its proprietor in Italy, or seek assistance from law enforcement to pursue the hackers who committed the theft, Mr. Brola filed this action against the Defendants, alleging a violation of Section 12(a)(1) of the Securities Act of 1933 (the "Securities Act" or the "Act") and claims for negligent misrepresentation and unjust enrichment.

The Section 12(a)(1) claim fails for several reasons. First, Mr. Brola has not adequately pled that Nano is a security. Nor could he do so. Material integral to the Complaint establishes that no one invested in Nano because all the Nano ever publicly distributed was given away for free. The Defendants never received any money in exchange for the issuance of Nano. And Mr. Brola does not allege otherwise. Moreover, because there were no investors, Mr. Brola fails to sufficiently allege commonality between Nano holders and the Defendants. No capital could be pooled from the distribution of Nano because no capital was raised. The test formulated by the Supreme Court in *SEC v. W.J. Howey, Co.* is directed to capital raises that fund a business, not mediums of exchange, like Nano. Nano's value does not derive from a group of managers or executives managing other people's property; rather, Nano's value is derived from its utility or potential utility as a currency. The primary purpose of securities law is to incentivize truthful disclosures by those who offer securities for sale. Yet, not only is all of Nano's software open source, but every single proposed change to Nano is made public and those who choose to run Nano software have the option whether to accept or reject a proposed update. Accordingly, there

is no further disclosure that would be incentivized by the application of securities laws to a cryptocurrency like Nano. In short, Nano is a currency, not a security.

Second, even were Nano considered a security, Mr. Brola's Section 12(a)(1) claim would still fail because he does not adequately plead that the Defendants are "statutory sellers." He does not allege that they had any contact with him or made any statements suggesting that he should buy Nano. Third, the claim would also fail because Mr. Brola does not sufficiently plead that he engaged in a domestic securities transaction. He only alleges that BitGrail is based in Italy and that BitGrail account holders hold and trade their cryptocurrency from their accounts on BitGrail's website. Mr. Brola does not allege that he used U.S.-based websites or servers to purchase Nano. Under the Supreme Court's *Morrison v. National Australia Bank* decision, U.S. securities laws do not apply outside of the United States.

Mr. Brola's state law claims fail because Mr. Brola omits from the Complaint entire elements of them. Accordingly, the Complaint should be dismissed with prejudice.

FACTS

In 2014, Defendant Colin LeMahieu, then a fulltime employee at Qualcomm, set out, in his spare time, to develop a new cryptocurrency that would improve on the flaws in the prevailing cryptocurrency at the time – Bitcoin.[1] Bitcoin was designed in a way that requires high amounts of computational power (termed "proof of work") to add transactions to the Bitcoin blockchain (a process known as "mining").[2] In exchange for performing this work a reward in Bitcoin is paid. Over time, as the Bitcoin network grew, the electricity required to

[1] Complaint ("Compl.") (Dkt. No. 1) at ¶ 2; Nano Whitepaper, ("Whitepaper") 1, https://nano.org/en/whitepaper (last visited Sept. 21, 2018).

[2] Whitepaper at 1.

mine Bitcoin transactions grew exponentially, as more and more miners, utilizing high-performance computers, were competing against each other for the reward.[3] Bitcoin transactions are batched by miners into a "block" of transactions and a new block is added to the Bitcoin blockchain at roughly 10-minute intervals, the average time it takes to perform the work of mining.[4] Mining is costly due to high equipment and energy prices, thus requiring a substantial fee to be charged by miners to those wishing to have their Bitcoin transactions processed – albeit a lower fee than typically charged by credit card companies to merchants.[5]

Against this background, Mr. LeMahieu sought to create a new cryptocurrency that used less electricity to validate transactions, dispensed with the need for transaction fees, and settled transactions quickly and securely.[6] In December 2014, Mr. LeMahieu published a whitepaper describing his concept for a cryptocurrency called "RaiBlocks" (the currency was later renamed "Nano"[7] and all references hereinafter are to Nano).[8] Nano was designed such that each account has its own blockchain rather than using one blockchain for the entire currency.[9] Since each account's blockchain is sequenced by the order in which it receives transactions, the Nano network is capable of operating asynchronously, as it does not need to wait for prior unrelated

---

[3] *Id.*

[4] *Id.*; Nano Website ("Website"): FAQ, https://nano.org/en/faq (last visited Sept. 21, 2018) ("How does Nano compare to other cryptocurrencies?").

[5] *Id.*

[6] Compl. at ¶ 25; Whitepaper at 1.

[7] Nano Rebrand Announcement (January 31, 2018), https://hackernoon.com/nano-rebrand-announcement-9101528a7b76.

[8] Compl. at ¶ 2.

[9] Website: FAQ, https://nano.org/en/faq (last visited Sept. 21, 2018) ("How does Nano work?"); Whitepaper at 1.

transactions in unrelated accounts to be verified before acknowledging new transactions.[10] If two conflicting transactions are received by the same account then all of the computers then online running Nano's software (termed "nodes") are asked to vote on which transaction was broadcast first, with the weight of each vote equal to the amount of Nano represented by each node. The winning transaction is recorded and the losing transaction is rejected. This process is automatic and occurs within seconds. After a transaction is properly received by an account, it is broadcast to all of the Nano nodes and recorded in a network-wide ledger of transactions.[11] Utilizing Mr. LeMahieu's novel design, Nano achieves near instantaneous transaction speeds with minimal energy use and, thus, close to zero fees, over a secure network, making it one of the most efficient cryptocurrencies currently in existence.[12]

On October 4, 2015, Mr. LeMahieu released his novel solution for a more efficient cryptocurrency, providing the public with a link to all of the software he had written related to the currency.[13] This same link can today be used by any member of the public to see and explore the Nano software and a history of all changes ever made to it. Mr. LeMahieu further decided that Nano would be released to the public for free, via a "Captcha-based faucet distribution system."[14] The Complaint contains no allegation that any recipient of Nano from the

---

[10] Whitepaper at 2.

[11] *Id.* at 2-4.

[12] *Id.* at 1; Website: FAQ, https://nano.org/en/faq (last visited Sept. 21, 2018) ("What are the advantages of Nano?").

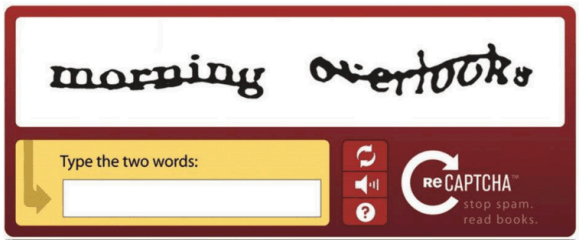
[13] Website: Resources, https://nano.org/en/resources/ (last visited Sept. 21, 2018); GitHub: Nanocurrency/raiblocks, https://github.com/nanocurrency/raiblocks (last visited Sept. 21, 2018).

[14] Website: FAQ, https://nano.org/en/faq (last visited Sept. 21, 2018). A CAPTCHA (an acronym for "Completely Automated Public Turing test to tell Computers and Humans Apart") is a type of Turing challenge-response test used in computing to determine whether or not the user is human. This is an example of a CAPTCHA test:

faucet paid any consideration, whether monetary or otherwise, to any of the Defendants in exchange for receiving the currency, and, indeed, no such payment ever occurred. On October 20, 2017, Mr. LeMahieu ended the faucet, reserved seven million Nano coins for the establishment of a developer fund[15] and destroyed the remaining supply of undistributed currency,[16] resulting in 133,248,290 Nano in circulation and the impossibility of any more Nano being released.[17]

After Nano was released, third parties, unconnected to the Defendants, established exchanges where users could trade other cryptocurrencies for Nano and vice versa.[18] One of the early exchanges to list Nano was BitGrail, which was owned and operated in Italy, with no operational presence outside Italy, by an Italian national, Franceso Firano.[19] The Complaint

---



Mr. LeMahieu used CAPTCHAs to prevent any one person from writing software to take a disproportionate amount of the currency. Depending on the number of CAPTCHAs solved over time, a user would receive a corresponding amount of Nano.

[15] Website: Nano Media Kit, https://nano.org/media/Nano%20Press%20Kit%204.0.pdf (last visited Sept. 21, 2018. The Nano Developer Fund is a publicly traceable fund used to maintain and improve upon the Nano software. *See* Nanode Website, https://www.nanode.co/account/xrb_1ipx847tk8o4 6 pwxt5qjdbncjqcbwcc1rrmqnkztrfjy5k7z4imsrata9est (last visited Sept. 21, 2018).

[16] A video of Mr. LeMahieu "burning" the remaining supply was posted the day the supply was destroyed. *See*YouTube, *XRB Burn* (Oct. 20, 2017), https://www.youtube.com/watch?v=jwR-CXNafLs.

[17] Compl. at ¶ 25.

[18] *See id.* at ¶ 1.

[19] *Id.* at ¶¶ 1, 6.

does not contain any allegation that Mr. LeMahieu or any of the other Defendants had any business relationship with Mr. Firano, and, indeed, no such relationship ever existed.

Plaintiff Alex Brola alleges that on December 10, 2017, he sent $50,000 to BitGrail to purchase Nano.[20] Mr. Brola does not allege that he sent any money to any of the Defendants or that he had any interaction with them.

In early January 2018, BitGrail users began to experience problems with their accounts and some were unable to withdraw funds.[21] Eventually, in early February 2018, Mr. Firano admitted that BitGrail had been hacked and a quantity of Nano, at the time worth approximately $170 million, was stolen.[22] BitGrail froze all accounts and no users were able to withdraw any funds from the exchange.[23] Mr. Brola subsequently filed this action.

ARGUMENT

I. LEGAL STANDARD

The standard for deciding a motion made under Federal Rule of Procedure 12(b)(6) is whether, taking all facts alleged in the complaint as true and drawing all reasonable inferences in favor of the plaintiff, the complaint states a cause of action.[24] The Court should not credit "mere conclusory statements or threadbare recitals of the elements of a cause of action."[25] "To survive

---

[20] *Id.* at ¶ 67.

[21] *Id.* at ¶¶ 39-41, 44.

[22] *Id.* at ¶ 47.

[23] *Id.* at ¶ 51.

[24] *Wu v. Pearson Educ., Inc.*, 09 Civ. 6557 (RJH), 2010 U.S. Dist. LEXIS 103488, at *4 (S.D.N.Y Sept. 30, 2010).

[25] *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).

a motion to dismiss, a complaint must contain sufficient factual matter . . . to 'state a claim to relief that is plausible on its face.'"[26] A claim is facially plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[27] More specifically, the plaintiff must allege sufficient facts to show "more than a sheer possibility that a defendant has acted unlawfully."[28]

II. SECURITIES CLAIM

A. Nano is Not a Security Under the *Howey* Test

Liability under Section 12(a)(1) of the Securities Act is, of course, limited to those persons who offer or sell "securities."[29] For the purposes of the Securities Act, a "security" is, "unless context otherwise requires":

> [A]ny note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[30]

---

[26] *Id.* at 678 (quoting *Twombly*, 550 U.S. at 570).

[27] *Id.* (citing *Twombly*, 550 U.S. at 556).

[28] *Id.*

[29] *See* 15 U.S.C. § 77l(a)(1).

[30] 15 U.S.C. § 77b(a)(1).

Congress's somewhat unusual mixture of the specific with the general has stood out almost since the Act's enactment. In one of the first cases requiring interpretation of the provision, Justice Jackson observed that:

> [T]he term "security" was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized, and the name alone carries well settled meaning. Others are of more variable character, and were necessarily designated by more descriptive terms, such as "transferable share," "investment contract," and "in general any interest or instrument commonly known as a security."[31]

Over the years, the Supreme Court has developed slightly different approaches to determine whether an instrument or interest is a security, depending on which part of the statutory definition is invoked. Where the instrument at issue is called a "stock," the courts will inquire whether it, in fact, has the characteristics traditionally associated with common stock.[32] Where the instrument is a "note," the courts will apply what has come to be known as the "family resemblance" test.[33] And, where the instrument or interest at issue appears to be one of those deemed by Justice Jackson to be of a "more variable character," – an "investment contract" or an "instrument commonly known as a security" – the courts will use the so-called *Howey* test.[34]

---

[31] *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 433, 351 (1943); *see also Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985) (endorsing the characterization of the definition found in *Joiner*); *Steinhardt Group Inc. v. Citicorp*, 126 F.3d 144, 150 (3rd Cir. 1997) ("Included in this definition are several catch-all categories which were designed to cover other securities interests not specifically enumerated in the statute.").

[32] *See Landreth*, 471 U.S. at 688-692.

[33] *See Reves v. Ernst & Young*, 494 U.S. 56, 64-67 (1990).

[34] *See United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975) ("We perceive no distinction, for present purposes, between an 'investment contract' and an 'instrument commonly known as a 'security.'' In either case, the basic test for distinguishing the transaction from other commercial dealings is [the *Howey* test].").

The *Howey* test derives from *SEC v. W.J. Howey Co.*,[35] a case in which the Court determined that a promoter's offer of tracks of citrus groves, with an option to also enter into a service contract for the harvest and marketing of the produce, was an invitation to enter into an "investment contract" notwithstanding part of the package's resemblance to a real estate offer.[36] "The test," according to the Court, was "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[37] Because of the likelihood that investors would pick up the option for the service contract, and thereby mutually depend on the promoter to manage their properties, the test was met.[38] These three elements – (1) an investment of money; (2) in a common enterprise; (3) with an expectation of profits to come solely from the efforts of others – have been refined over the years but continue to comprise the standard by which the existence of an investment contract is determined.

Mr. Brola alleges that Nano coins are investment contracts and dutifully recites the *Howey* elements.[39] He fails, however, to include in the Complaint a single non-conclusory factual allegation that, if proved, would help to establish any of these elements. This complete absence of well-pled facts on the issue is not surprising given that Mr. Brola's own allegations, and documents integral to the Complaint, clearly show that Nano does not reflect investment contracts or otherwise meet the Act's definition of a security.

To begin with, conspicuously absent from the Complaint is any allegation that Mr. Brola,

---

[35] 328 U.S. 293 (1946).

[36] *See id.*

[37] *Id.* at 301.

[38] *See id.* at 300.

[39] *See* Compl. at ¶¶ 56-59.

or anyone else, invested anything of value in the distribution of Nano. To be sure, *Howey's* first element – the investment of money – can be met without a literal exchange of cash between the promoter and security purchaser.[40] But in all cases, the purchaser must tender "some tangible and definable consideration" if his interest is to be considered as security.[41] Even the so-called "free stock" SEC enforcement actions of the late 1990s, to which the more-inclusive *Landreth*, stock, test applied,[42] involved the receipt of valuable services.[43]

Here, the very website on which Mr. Brola bases much of the Complaint makes clear that Nano were released by the Defendants free of charge. Outside of the labor required to complete the CAPTCHA test – which was of no value to anyone associated with the development or release of Nano – the recipients of Nano contributed nothing in return for their Nano.[44]

---

[40] *See, e.g.*, *Uselton v. Commercial Lovelace Motor Freight*, 940 F.2d 564, 575-76 (10th Cir. 1991) (holding that employee contributions to an employee stock ownership plan constitute an investment for the purposes of the *Howey* test, even though the contributions were withheld and remitted by the employer); *SEC v. Shavers*, No. 13-CV-416, 2014 U.S. Dist. LEXIS 194382, at *13-15 (E.D. Tex. Aug. 26, 2014) (holding that exchange of Bitcoin for an instrument satisfies the investment prong of the *Howey* test).

[41] *Int'l Brotherhood of Teamsters, Chauffers, Warehousemen and Helpers v. Daniel*, 439 U.S. 551, 560 (1979).

[42] *See supra* note 34 and accompanying text.

[43] Press Release 99-83, SEC, SEC Brings First Actions To Halt Unregistered Online Offerings of So-Called "Free Stock" (July 22, 1999), *available at* https://www.sec.gov/news/press/pressarchive/1999/99-83.txt; *cf. SEC v. Sierra Brokerage Servs Inc.*, 608 F. Supp. 2d 923, 940-43 (S.D. Ohio 2009), *aff'd* 712 F.3d 321 (6th Cir. 2013) (holding that the cashless transfer of a shell company's stock amounted to a "sale" because widespread distribution of the securities was needed to make the company attractive for a reverse merger, thereby benefiting the promotor); *SEC v. Harwyn Indus. Corp*., 326 F. Supp. 943, 952-54 (S.D.N.Y. 1971) (holding cashless distribution of a subsidiary's stock to the parent-company shareholders was a "sale" because creation of an active trading market in the stock facilitated future financing of the subsidiary).

[44] *See* Website: FAQ, https://nano.org/en/faq (last visited Sept. 21, 2018) ("Nano is not mined and has reached its maximum supply of 133,248,290 NANO. Funds were initially distributed via a captcha-based faucet distribution system that ended in October 2017.").

That free Nano proved useful as a medium of exchange, and so acquired value after their distribution, is irrelevant. And, thus, so too is Mr. Brola's claim[45] that he paid $50,000 for Nano on a cryptocurrency exchange. As the Supreme Court has recognized "[t]he focus of [the Securities and Securities Exchange Act of 1934 ("the Exchange Act")] is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes . . . ."[46] The "investment" at issue in the *Howey* test, therefore, must be made with the *promoters* of the alleged security. Nothing less is sufficiently related to capital formation.

So axiomatic is this principle that there does not appear to be a single reported case in which a plaintiff has so much as argued that an instrument or interest truly issued for free constitutes a security. It also explains why the Chairman of the Securities and Exchange Commission, Jay Clayton, has repeatedly affirmed that Bitcoin, which like Nano distributes its coins without charge, is not a security. Speaking to CNBC in June, Mr. Clayton stated, "Cryptocurrencies: These are replacements for sovereign currencies, replace the dollar, the euro, the yen with bitcoin. That type of currency is not a security."[47]

The point becomes even more salient when recent enforcement investigations and actions involving so-called "Initial Coin Offerings" or "ICOs" are considered. In *United States v. Zaslavskiy*, for example, the Government is currently moving forward with an indictment against

---

[45] *See* Compl. at ¶¶ 11, 67.

[46] *Forman*, 421 U.S. at 849.

[47] Kate Rooney, *SEC Chief Says Agency Won't Change Securities Laws to Cater to Cryptocurrencies*, CNBC (June 6, 2018, 10:45 AM), https://www.cnbc.com/2018/06/06/sec-chairman-clayton-says-agency-wont-change-definition-of-a-security.html; *see also* Neeraj Agrawal, *SEC Chairman Clayton: Bitcoin is Not a Security*, Coin Center (Apr. 26, 2018), https://coincenter.org/link/sec-chairman-clayton-bitcoin-is-not-a-security ("A pure medium of exchange, the one that's most often cited, is Bitcoin. As a replacement for currency, that has been determined by most people to not be a security.").

a promoter whom it accuses of staging an ICO of cryptocurrency "tokens" or "coins" supposedly backed by real estate assets and diamonds.[48] The Government alleges that over a thousand investors used credit cards, wire services, and online exchanges to send cash and cryptocurrency to the promoter's companies in return for promises to deliver the coins.[49] If true, clearly this is an investment of money. On similar facts, the Securities and Exchange Commission recently issued a cease and desist order to a promoter and his company who offered digital tokens, convertible to equity, in an attempt to raise $5 million for supposed oil and gas exploration.[50] Although, the respondents were ultimately unable to raise any cash through the ICO, they did exchange approximately 80,000 tokens in exchange for online promotional and marketing services.[51] The barter of these valuable services for the tokens constituted an investment for *Howey* purposes.[52] And, last year, the Securities and Exchange Commission released a report of its investigation of an ICO by an unincorporated organization known as The DAO, which issued certain equity-like digital tokens in exchange for cryptocurrency.[53] The Commission concluded that payment of cryptocurrency to The DAO for the tokens was an investment.[54] By contrast to

---

[48] *See* No. 17-CR-647 (RJD), slip op. at 2-4 (E.D.N.Y. Sept. 11, 2018).

[49] *Id.* at 11.

[50] *In re Tomahawk Exploration LLC*, Securities Act Release No. 10530, Exchange Act Release No. 83839, slip op. ¶ 1 (Aug. 14, 2018), https://www.sec.gov/litigation/admin/2018/33-10530.pdf.

[51] *Id.* at ¶¶ 1, 22.

[52] *Id.* at ¶ 2.

[53] *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (Jul. 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf.

[54] *See id.* at 11.

these cases involving securities, there is no allegation in the Complaint – nor could one be made in good faith – that any goods or services passed to the developers of Nano coin in connection with its distribution.

Mr. Brola also fails to sufficiently plead the existence of a common enterprise, the second *Howey* element. Indeed, in the absence of any investment in Nano, "commonality" – as the defining characteristic of this element is known – between Nano holders and the Defendants is impossible.

The lead case on commonality in the Second Circuit, and perhaps nationwide, remains *Revak v. SEC Realty*.[55] In *Revak* the court formally endorsed so-called "horizontal commonality" as an applicable standard for determining whether an investment is in a common enterprise.[56] It held open the possibility – as yet still not tested at the appellate level[57] – that "strict vertical commonality" could also suffice,[58] and it rejected the application of "broad vertical commonality," which some other circuits had accepted.[59]

Horizontal commonality is "the tying of each individual investor's fortunes to the fortunes of other investors by the pooling of assets, usually combined with the pro-rate distribution of profits."[60] Investment in the interest or instrument alleged to be a security is a

---

[55] 18 F.3d 81 (2d Cir. 1994).

[56] *See id.* at 87.

[57] *See Zaslavskiy*, Slip Op. at 12 n.7.

[58] *See Revak*, 18 F.3d at 88.

[59] *See id.*; *cf. SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478 (5th Cir. 1974) (espousing a theory of broad vertical commonality, rejected by *Revak*, in which "the critical factor is . . . the uniformity of impact of the promotor's efforts").

[60] *Revak*, 18 F.3d at 87; *see also Wals v. Fox Hills Development Corp.*, 24 F.3d 1016, 1019 (7th Cir. 1994) (Posner J.) (arguing that the Securities Act's disclosure requirement "makes sense

prerequisite for establishing horizontal commonality; and, as discussed above, Mr. Brola has failed to adequately plead an investment by anyone in Nano. Put simply, to pool assets, multiple people must first *invest* those assets. Since the participants in the release of Nano contributed no capital – monetary or otherwise – there are no assets for the Defendants to pool or that could generate profits for distribution.

But what should be made of Mr. Brola's allegation in Paragraph 58 of the Complaint that "the cryptocurrency and fiat currency were pooled under the control of the Defendants?" This allegation is conclusory, and utterly unconnected to the rest of the pleadings. Questions about the assertion abound, such as: What currency? How was it obtained? From whom? In exchange for what? Nothing in the Complaint even hints at answers.[61]

Finally, even were the other *Howey* elements well-pled, Mr. Brola would have still failed to sufficiently allege that he, or anyone else, had a reasonable expectation of profits from the receipt of Nano. The Supreme Court has stated that its use of the term "profits" in the *Howey* test "has always meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds."[62] Put more simply, the principle "is only that the expected profits must, in conformity with ordinary

---

only if the investors are obtaining the same thing, namely an undivided share in the same pool of assets and profits").

[61] As noted above, the Second Circuit has not yet ruled out strict vertical commonality as an acceptable theory of common enterprise. Strict vertical commonality requires only that "the fortunes of the investors be tied to the fortunes of the promotor." *Revak*, 18 F.3d at 88; *see also Brodt v. Bache*, 595 F.2d 459, 461 (9th Cir. 1978) (requiring "direct correlation on either the success or failure side" between investor and the promotor). Once again, however, as be seen from the Second Circuit's formulation of the standard, investment is required.

[62] *Forman*, 421 U.S. at 852.

usage, be in the form of financial return on the investment, not in the form of consumption."[63] "[W]hen a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply."[64] Where motives are mixed, courts will look to the holder's "primary" motive.[65] This has meant, for example, that fixed lease payments in sale and leaseback arrangements are "profits,"[66] but the right to lease an apartment conferred through ownership of shares in a housing cooperative are not.[67]

The only reasonable inference that can be drawn from the Complaint, and the website on which it relies, is that Nano holders obtain Nano to use – or "consume" – it. Under the heading "The Allure of XRB," Mr. Brola alleges that "XRB transactions are instant, with no fees, and have no limit to their scalability."[68] "Moreover," he continues, "the amount of power required to transact XRB is miniscule, which puts everyday transactions of XRB within the realistic reach of even the most novice XRB consumer."[69] Even leaving aside Mr. Brola's use of the word "consumer" to describe Nano holders, the qualities he touts all relate to Nano's intrinsic utility. By contrast, nowhere in the Complaint is there any reference to any prospects of financial return

---

[63] *SEC v. Life Partners, Inc.*, 87 F.3d 536, 543 (D.C. Cir. 1996).

[64] *Forman*, 421 U.S. at 852-53.

[65] *See, e.g.*, *Rice v. Branigar Org. Inc.*, 922 F.2d 788, 790-91 (11th Cir. 1991) ("We hold that the lots are not securities under the 1934 Act. We believe that people buy houses and lots in a beach-club development primarily to use them, not to derive profits from the entrepreneurial efforts of the developers."); *Grenader v. Spitz*, 537 F.2d 612, 618 (2d Cir. 1976) ("[T]he documentary evidence . . . would indicate that the profit motive [in purchasing shares in a housing cooperative], if any, was purely incidental.").

[66] *See SEC v. Edwards*, 540 U.S. 389 (2004).

[67] *See Forman*, 421 U.S. at 858; *Grenader*, 537 F.2d at 618-19.

[68] Compl. at ¶ 25.

[69] *Id.*

associated with holding Nano. This is consistent with a common-sense understanding of currency. While it's true that people may trade, or hold for future trading, one currency for another – sometimes for a profit – the primary reason for holding money is to use as a medium of exchange. This is clearly the case with respect to Nano, which the website touts exclusively on the basis of its functionality.[70]

B. The Defendants are Not Statutory Sellers Under Section 12

Even if Nano were "securities" under the Securities Act, Mr. Brola's Section 12 claim would fail. Under Section 12, a plaintiff can only recover against a narrow category of defendants. Section 12 liability can only arise where the defendant either (1) passed title to a security directly to the plaintiff, or (2) "solicited" the purchase of a security by the plaintiff.[71] Here, Mr. Brola does not allege that he took title to Nano from any of the Defendants. Nor does Mr. Brola allege with specificity that any of the Defendants "solicited" him to purchase Nano.

In the absence of an actual sale to the plaintiff, courts, including the Supreme Court, have been cautious to impose liability on actors who are peripheral to the transaction. The case law makes clear that the level of contact between the parties needs to be both substantial and of a specific nature to constitute solicitation. "Congress did not intend that the section impose liability on participants 'collateral to the offer or sale' or even those whose conduct constituted 'substantial participation in the sales transaction.'"[72] In *Pinter v. Dahl*, the Court explained that

---

[70] *See* Website, https://nano.org/en (last visited Sept. 21, 2018) ("Use Cases for Nano").

[71] *Pinter v. Dahl*, 486 U.S. 622, 642-643 (1988).

[72] *Youngers v. Virtus Investment Partners Inc.*, 195 F. Supp. 3d 499, 522 (S.D.N.Y. 2016). Much of the case law on statutory sellers involves Section 12(a)(2) claims, but the reasoning of those cases applies equally to claims brought under Section 12(a)(1). *See Steed Fin. LDC v. Nomura Secs. Int'l, Inc.*, No. 00-CV-8058, 2001 U.S. Dist. LEXIS 14761, at *20-21 (S.D.N.Y. Sept. 20, 2001).

where a broker is acting as an agent for a principal and successfully solicits a purchase for the principal, the broker is also liable as a statutory seller under Section 12 despite not passing title.[73] But the Court cautioned that Section 12 should not be applied to remotely involved actors who could only be said to be a "proximate cause" of the transaction.[74]

Consistent with the Supreme Court's prohibition against liability for remote actors, courts have rejected numerous types of conduct as being "solicitation" under Section 12. For example, in *Youngers*, the defendant was a fund manager and one of the funds it managed sold securities to a class of plaintiffs who later alleged Section 12 violations.[75] The court dismissed the claims against the fund manager, holding that it was not a "statutory seller" despite having made marketing materials about the security available on its website and through other channels.[76] Further, the plaintiffs in *Youngers* failed to allege that the fund manager had an agency relationship with the brokers who directly solicited the class action plaintiffs to buy the security.[77] In *F.W. Webb Compay v. State Street Bank & Trust.*, the court dismissed claims that an investment advisor engaged in "solicitation" because the advisor did not have direct contact with the buyers of the security and did not urge the buyers to make a purchase.[78] And in *Steed*

---

[73] *Pinter*, 486 U.S. at 646.

[74] *Id.* at 651.

[75] *Youngers*, 195 F. Supp. 3d at 508-509.

[76] *Id.* at 522 ("At most, the Complaint alleges that Virtus Partners distributed the marketing materials 'through their website and other channels.' But such allegations are insufficient." (internal citation omitted)).

[77] *See id.* at 523 ("The Complaint alleges only that Aylward and Virtus Partners supervised the wholesalers marketing of the funds to the brokers, not that they controlled the brokers or that the brokers served as their agents.").

[78] No. 09-CV-1241, 2010 U.S. Dist. LEXIS 82759, at *51-52 (S.D.N.Y. Aug. 12, 2010).

Finance LDC v. Nomura Securities International, the court rejected claims that a defendant "solicited" because the complaint did not allege "specific acts by [the defendant] to directly solicit [the plaintiff] to purchase" the securities at issue in that case.[79] Indeed, the court noted that the plaintiff would have needed to allege that the defendant "actively solicited investors" and that the "plaintiff purchased the securities as a result of [the defendant's] solicitation."[80]

Clearly, Mr. Brola fails to allege facts that would establish that the Defendants are statutory sellers. Mr. Brola alleges that on December 10, 2017, he was at his home and logged onto BitGrail's website to make a purchase of Nano.[81] He does not identify any specific statement that induced his purchase. Mr. Brola does not allege that he communicated with any of the Defendants prior to or at the time of his purchase. And he does not allege facts showing an agency or broker relationship between any of the Defendants and BitGrail.

Indeed, Mr. Brola identifies only one statement made by any of the Defendants. On January 12, 2018, one of the Defendants allegedly said: "Yes you can [trust him]. I talk to Bomber every day and he's a good guy. We'll get it all sorted next week. Just hang in there." That statement was allegedly made about one month *after* Mr. Brola allegedly made his purchase and does not include any language urging Mr. Brola or others to buy Nano. Accordingly, that statement cannot support a conclusion that the Defendants are statutory sellers under Section 12.

The remainder of the Section 12 material in the Complaint is nothing more than labels and legal conclusions. For example, Mr. Brola repeatedly alleges with no elaboration that the Defendants "solicited," "promoted" or made "specific instructions" and "representations" to the

---

[79] No. 00-CV-8058, 2001 U.S. Dist. LEXIS 14761, at *22 (S.D.N.Y. Sept. 20, 2001).

[80] *Id.*

[81] Compl. at ¶¶ 1, 11, 67, 68.

plaintiff.[82] Such allegations are no more than "naked assertions devoid of further factual enhancement,"[83] and Mr. Brola fails to identify the timeframe for most of those alleged "solicitations." The closest Mr. Brola gets to alleging a pre-purchase statement is: "At times relevant hereto, [the Defendants] each took to social media outlets – including Twitter, Facebook, Medium, and Reddit – to promote [Nano] . . . ."[84] Missing here are any allegations about the content of the statements, who made them, or when they were made. *Iqbal* and *Twombly* require more than that; the Complaint only contains allegations that, at best, give rise to a "sheer possibility" that the Defendants solicited Mr. Brola's purchase.[85]

C. U.S. Securities Laws Do Not Apply to a Transaction in Italy

i. *Morrison* Prohibits Extraterritorial Application of U.S. Securities Laws

In *Morrison v. National Australia Bank*, the Supreme Court held that the federal securities laws apply only to (1) transactions on U.S. securities exchanges, and (2) "domestic transactions in other securities."[86] The Court noted the presumption against extraterritorial application of U.S. laws, stating that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."[87] Because the Exchange Act contains no indication that Section 10(b) applies abroad, the Supreme Court held that Section 10(b) has no extraterritorial

---

[82] Compl. at ¶¶ 1, 2, 4, 5, 29.

[83] *Iqbal*, 556 U.S. at 678 (internal citations and quotes omitted).

[84] Compl. at ¶ 36.

[85] *Iqbal*, 556 U.S. at 678 (citing *Twombly*, 550 U.S. at 556).

[86] 561 U.S. 247, 267 (2010).

[87] *Id.* at 255.

application.[88] Courts in this circuit have found that *Morrison's* holding applies to claims brought under Sections 11 and 12 of the Securities Act.[89]

In *Morrison*, the Supreme Court repudiated earlier case law that had applied U.S. securities laws to foreign securities transactions that were accompanied by some level of "conduct" or "effects" in the United States.[90] The Supreme Court specifically rejected a test proposed by the Solicitor General, appearing on behalf of the Securities and Exchange Commission, under which Section 10(b) would be violated when a securities fraud involves significant conduct in the United States that is material to the fraud's success.[91] Holding that Section 10(b) prohibits not the making of deceptive statements in the United States, but only the making of deceptive statements in connection with securities transactions that take place in the United States,[92] the Supreme Court announced a clear "transactional test" – "whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange."[93] Thus, post-*Morrison*, Section 10(b) of the Exchange Act, and Sections 11 and 12 of the Securities Act, apply only to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities."[94]

---

[88] *See id.* at 265.

[89] *In re Smart Techs., Inc.*, 295 F.R.D. 50, 56 (S.D.N.Y. 2013) ("[T]o the extent that a plaintiff seeks to impose liability under sections 11 or 12(a)(2), that individual must have purchased a security listed on a domestic exchange or engaged in a 'domestic transaction in other securities.'").

[90] *See Morrison* 561 U.S. at 255-59.

[91] *See id*. at 270-73.

[92] *Id*. at 266.

[93] *Id.* at 269-70.

[94] *Id.* at 267; *In re Smart Techs., Inc.*, 295 F.R.D. at 56.

ii. What is a "Domestic" Transaction?

With the advent of widespread Internet access, counterparties to a securities transaction may be anywhere in the world and may transact through intermediaries who also may be anywhere in the world. To address that geographic dispersion, courts have defined the "location of the transaction" under *Morrison* as the location where "irrevocable liability" was incurred.[95] This determination requires courts to consider a wide array of information, including, among other things, the "formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money."[96]

No one fact controls the outcome of whether a transaction is domestic. For example, a transaction is not domestic, without more, just because one of the following facts is established: the issuer is based in the United States, the investor is a U.S. resident; the investor placed a purchase order in the United States; the dealer is in the United States; the security is issued and registered in the United States; or the investor wired funds to the United States.[97] Indeed, since *Morrison*, district courts have rejected the argument that a purchase or sale of a security on a foreign exchange takes place "in the United States" if the purchase or sale order is made from the United States.[98]

---

[95] *See, e.g.*, *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 62 (2d Cir. 2012); *SEC v. Levine*, 462 Fed. Appx. 717, 719 (9th Cir. 2011).

[96] *Absolute Activist*, 677 F.3d at 69, 70; see also *United States v. Georgiou*, 777 F.3d 125, 136 (3d Cir. 2015).

[97] *See Loginovskaya v. Batratchenko*, 764 F.3d 266, 274-75 (2d Cir. 2014); *City of Pontiac*, 752 F.3d at 181-82 & n.33; *Absolute Activist*, 677 F.3d at 68-70 (2d Cir. 2012).

[98] *See, e.g.*, *In re Satyam Computer Servs. Ltd. Sec. Litig.*, 915 F. Supp. 2d 450, 473-74 (S.D.N.Y. 2013); *Pope Invs. II, LLC v. Deheng Law Firm*, No. 10-CV-6608, 2012 U.S. Dist. LEXIS 115282, at *17-24 (S.D.N.Y. Aug. 15, 2012); *In re UBS Sec. Litig.*, No. 07-CV-11225, 2011 U.S. Dist. LEXIS 106274, at *7-25 (S.D.N.Y. Sept. 13, 2011), *aff'd sub nom. City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173 (2d Cir. 2014); *In re*

In *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings*, the Second Circuit elaborated that in order to adequately allege the existence of a domestic transaction under *Morrison*, a plaintiff should allege facts showing "that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security."[99] The court set forth a foreign "predominance" test: "Although we recognize that the plaintiffs allege that the false statements may have been intended to deceive investors worldwide, we think that the relevant actions in this case are so predominantly German as to compel the conclusion that the complaints fail to invoke § 10(b) in a manner consistent with the presumption against extraterritoriality."[100] Conclusory allegations as to where liability became irrevocable are not sufficient.[101]

Absolute Activist makes clear that a party's residence is irrelevant to the location of a transaction: "While it may be more likely for domestic transactions to involve parties residing in the United States, '[a] purchaser's citizenship or residency does not affect where a transaction occurs; a foreign resident can make a purchase within the United States, and a United States resident can make a purchase outside the United States.'"[102] The Second Circuit later held in *City of Pontiac Policemen's & Firemen's Retirement System v. UBS AG*, that "the mere placement of a buy order in the United States for the purchase of foreign securities on a foreign

---

Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512, 532-33 (S.D.N.Y. 2011), *aff'd* 838 F.3d 223 (2d Cir. 2016).

[99] 763 F.3d 198, 212 (2d Cir. 2014) (citing *Absolute Activist*, 677 F.3d at 69).

[100] *Id.* at 216.

[101] *Id.* at 212 (citing *Absolute Activist*, 677 F.3d at 69-71).

[102] 677 F.3d at 69 (quoting *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 178 (S.D.N.Y. 2010)).

exchange, without more," is insufficient to "allege that a purchaser incurred irrevocable liability in the United States."[103] In relevant part, the *City of Pontiac* court noted that "a purchaser's citizenship or residency does not affect where a transaction occurs."[104]

iii. Mr. Brola Purchased Nano in Italy

The Complaint includes very little detail regarding Mr. Brola's purchase of Nano on the BitGrail exchange. The only detailed factual allegations are that he accessed BitGrail's website from his home in Arizona, transmitted $50,000 to BitGrail, held his Nano and traded them on the BitGrail exchange.[105] The Court can infer from these facts that, due to Mr. Brola's location, his money was in the United States as well. Additionally, based on BitGrail's location in Florence, Italy, the Court can infer that any currency in BitGrail's possession was located in Italy. Mr. Brola also alleges that BitGrail account holders both held their coins in and traded the coins from their BitGrail accounts.[106] The only reasonable inference to be drawn from these allegations is that Mr. Brola's purchase of Nano was transacted on BitGrail's computers located in Florence, Italy. Certainly, Mr. Brola does not plead any facts to the contrary.

Missing from the Complaint are any allegations regarding how Mr. Brola transferred his money to the BitGrail exchange and where his money was located prior to being transferred. Mr. Brola avoids the details of how his money was sent to BitGrail, which is an essential fact given that Bitrgail did not accept U.S. Dollars or any other fiat currency and was only a

---

[103] *City of Pontiac Policemen's & Firemen's Retirement System v. UBS AG*, 752 F.3d 173, 181 & n.33 (2d Cir. 2014).

[104] *Id.* (quoting *Absolute Activist*, 677 F.3d at 69).

[105] Compl. at ¶ 11.

[106] *Id.* at ¶ 3.

cryptocurrency-to-cryptocurrency exchange.[107] As such, an essential link in the transaction chain is missing. Mr. Brola would have had to have first converted his dollars to a cryptocurrency on another exchange and then transferred that cryptocurrency to BitGrail to buy Nano. This additional step, which may well have occurred abroad, serves only to further minimize the likelihood of the transaction's connection to the United States.

As discussed above, the case law makes abundantly clear that merely placing a buy or sell order in the United States is not sufficient to bring about an application of Section 12. Since the Complaint does not contain any allegation to rebut the presumption, established by Mr. Brola himself, that BitGrail's operations – electronic, financial, or otherwise – are located in Italy, the Court can only infer that Mr. Brola's purchase of Nano occurred outside of the United States.[108]

III. STATE LAW CLAIMS

Mr. Brola's state law claims for negligent misrepresentation and unjust enrichment fail because he has failed to allege in a non-conclusory fashion all of the elements of those causes of action. Under New York law, a negligent misrepresentation plaintiff must allege, among other things, that the defendant relied on a statement in taking, or forbearing to take, some action.[109] Here, the only statement identified in the Complaint is Defendant Zack Shapiro's January 12, 2018 statement about whether Mr. Firano could be trusted. As set forth above, Mr. Brola allegedly made his purchase in December 2017, and thus could not have relied on the January

---

[107] *See* BitGrail Fees, https://bitgrail.com/fees (last visited Sept. 21, 2018).

[108] *Cf. In re Tezos Secs. Litig.*, 17-CV-06779, 2018 U.S. Dist. LEXIS 157247, at *25 (N.D. Cal. Aug. 7, 2018) (rejecting a *Morrison* argument where the plaintiff alleged that the ICO token at issue was distributed through a website hosted in the United States run by a U.S. citizen, with many computers in the distributed network located in the United States).

[109] *Anschutz Corp. v. Merrill Lynch & Co.*, 690 F.3d 98, 114 (2d Cir. 2012).

2018 statement in taking or forbearing from taking an action. And this is the only allegation of reliance on any of the Defendants' statements.

In New York, one element of an unjust enrichment claim is that the defendant is enriched at the plaintiff's expense,[110] which requires a connection or contact between the two parties. Here, at most, Mr. Brola alleges that, but for the Defendants, there would have been no Nano for him to buy and so he would not have lost money in a hack on the BitGrail exchange. The Defendants are not alleged to be responsible for the hack and it is unclear how the Defendants were enriched in connection with Mr. Brola's loss. Accordingly, the state law claims fail.

CONCLUSION

In light of the foregoing, the Defendants respectfully request that the Court dismiss Mr. Brola's Section 12(a)(1) claim and his negligent misrepresentation and unjust enrichment claims.

[110] *Myun-Uk Choi v. Tower Research Capital LLC*, 165 F. Supp. 3d 42, 50 (S.D.N.Y. 2016), *vacated on other grounds* 886 F.3d 229 (2d Cir. 2016) ("(1) that the defendant was enriched; (2) that the enrichment was at the plaintiffs expense; and (3) circumstances are such that in equity and good conscience, the defendant should return the money or property to the plaintiff.").

Date: September 21, 2018

Respectfully submitted,

/s/ Peter Scoolidge
Peter Scoolidge (PS7107)
Peter@ScoolidgeLLP.com
Peter Fox (PF1893) (*of counsel*)
SCOOLIDGE LLP
315 West 36th Street
New York, NY 10018
Tel: (212) 913-9455
Fax: (866) 344-5070

Attorneys for Defendants Hieusys, LLC, Colin LeMahieu, Troy Retzer, and Mica Busch

/s/ Shawn Naunton
Shawn Naunton
Vanessa Garcia
ZUCKERMAN SPAEDER LLP
485 Madison Avenue
New York, NY 10022
(212) 704-9600

Attorneys for Defendant Zack Shapiro