Binance Ruling Spotlights Muddled Post-Morrison Landscape

By **Andrew Rhys Davies and Jessica Lewis** (April 19, 2024)

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The March decision in Williams v. Binance from the U.S. Court of Appeals for the Second Circuit[1] marks the latest chapter in the judiciary's struggle to apply the U.S. Supreme Court's 2010 decision in Morrison v. National Australia Bank Ltd. to nontraditional transactions or nontraditional assets — in this case, digital assets.

The plaintiffs in Williams v. Binance sued under the federal securities laws to rescind secondary-market purchases of allegedly worthless tokens they made on the Binance trading platform. They asserted that the tokens were unregistered securities and that Binance was operating as an unregistered securities exchange and broker-dealer.

Binance moved to dismiss, arguing that, even assuming the tokens are securities, the claims exceeded the territorial limitations that Morrison imposed on the federal securities laws.[2]

In Morrison, the Supreme Court held that the anti-fraud provisions of the federal securities laws, including Section 10(b) of the Securities Exchange Act of 1934, do not provide a cause of action to investors who are injured in securities transactions outside the U.S.[3] In other words, those suing under the federal securities laws must have entered into domestic transactions.[4]

Morrison tried to draw a bright line between foreign and domestic transactions to replace the unpredictable conduct-and-effects test that previously dictated when the federal securities laws might apply to transactions with a foreign component.[5] But if the promise of Morrison was a predictable way to determine the geographical reach of the federal securities laws, the rise of decentralized transactions in digital assets has called that promise into question.

This article explores the evolution — or convolution — of Morrison in the Second Circuit, and how the recent decision in Williams v. Binance has highlighted Morrison's limitations when applied to transactions in digital assets.

Pre-Binance: The Second Circuit Muddies Morrison by Creating "Predominantly Foreign" Carveout

In the wake of Morrison, every circuit to evaluate whether a transaction is "domestic" and thus within the scope of the federal securities laws' anti-fraud provisions has adopted the so-called irrevocable liability test.[6] Under this test, a transaction is domestic if "irrevocable liability was incurred or ... title was transferred within the United States," as the Second Circuit outlined in Absolute Activist Value Master Fund Ltd. v. Ficeto in 2012.[7]

However, though the Second Circuit has embraced the irrevocable liability test, it has also adopted a judicial carveout or gloss that other circuits have criticized as, once again, muddying the waters of Morrison.

Just four years after Morrison, the Second Circuit held in Parkcentral Global Hub Ltd. v.

Porsche Automobile Holdings that Exchange Act claims will not arise from domestic transactions if the claim is nonetheless "so predominantly foreign as to be impermissibly extraterritorial."[8]

Parkcentral arose from allegations of fraud in connection with domestic swap transactions, but the Second Circuit held that the claims were predominantly foreign because those swaps referenced the stock of a non-U.S. company that was listed only on foreign exchanges. As the Second Circuit saw it, the swaps were the economic equivalent of trading stock on foreign exchanges.

The First and Ninth Circuits have rejected the Second Circuit's "predominantly foreign" carveout.[9]

In Stoyas v. Toshiba Corp., the U.S. Court of Appeals for the Ninth Circuit in 2018 rejected the argument that purchases of American depositary receipts should fall outside the reach of the federal securities laws because they — like the swaps at issue in Parkcentral — allow U.S. investors to hold beneficial interests in companies listed overseas. The Ninth Circuit declined to follow Parkcentral because it is "contrary to Section 10(b) and Morrison itself."[10]

The U.S. Court of Appeals for the First Circuit relied on Stoyas to reach the same conclusion in U.S. Securities and Exchange Commission v. Morrone in 2021.[11]

Nevertheless, also in 2021, the Second Circuit took the "predominantly foreign" standard further in Cavello Bay Reinsurance Ltd. v. Shubin Stein, to affirm the dismissal of Exchange Act claims arising from a securities transaction into which two Bermudan parties entered in New York.

There, the Second Circuit reiterated that "the presence of a domestic transaction alone cannot satisfy the statute's geographic requirements" if the claims are predominantly foreign.[12] Even though the purported misstatements occurred in New York and the parties partially executed the agreement in New York, the claims were "impermissibly extraterritorial," largely because the parties were not U.S. investors and the transaction was structured to avoid the application of U.S. securities laws.[13]

Questions Williams v. Binance Leaves Open When It Comes to Digital Assets

The Second Circuit's decision in Williams v. Binance does not explain why the "predominantly foreign" carveout does not bar claims arising from purchases of digital assets on a trading platform provided by a non-U.S. company.

The plaintiffs in this case sued under the federal securities laws, seeking the rescission of token purchases they made on Binance's trading platform. The U.S. District Court for the Southern District of New York dismissed, holding that the plaintiffs had not sufficiently alleged the domestic transaction required by Morrison.

In particular, the district court held that the plaintiffs did not plead a domestic transaction by alleging that title to the tokens "passed in whole or in part over [third-party] servers located in California that host Binance's website."[14]

The Second Circuit reversed, finding it plausible that the investor plaintiffs incurred irrevocable liability to purchase the tokens in the U.S. As the Second Circuit saw things, the plaintiffs placed their orders from their homes in the U.S., so it was plausible that they

became irrevocably committed to purchase when those orders were matched on the third-party servers located in California.[15]

The Second Circuit cautioned, however, that "it may not always be appropriate" to determine whether a digital asset transaction is domestic or foreign "solely based on the location of the servers the exchange runs on."[16] The court acknowledged its prior holding that a transaction is not domestic simply because the investor places their order from the U.S.,[17] but brushed it aside because "here the relevant exchange disclaims any location, foreign or otherwise."[18]

In the Second Circuit's view, the trading platform's lack of nexus to any jurisdiction, foreign or domestic, alleviated the comity considerations that Morrison sought to address.

Williams v. Binance illustrates the challenges of applying Morrison to nontraditional transactions in nontraditional assets. A pending petition for en banc review highlights some of the questions that will have to be answered in this and future cases.

Why should the federal securities laws apply based solely on the location of third-party servers? As the Ninth Circuit held in February in Daramola v. Oracle America Inc.: "Given the ubiquity of server connections to and through the United States, treating such a tenuous connection as sufficient domestic conduct would effectively negate the presumption against extraterritoriality."[19]

Even if in-forum servers are sufficient to make a transaction domestic, how does the Second Circuit's "predominantly foreign" carveout apply to claims where third-party servers represent the only nexus to the U.S.?

Why does the U.S. residence of the plaintiffs make it plausible that their purchases were matched on the U.S.-based servers? What if the plaintiffs had been foreign residents? Would it still have been plausible that their purchases were matched in the U.S.? Why or why not?

Notably, although the named plaintiffs in Williams v. Binance allegedly are U.S. residents, the putative class appears to include investors worldwide.

Conclusion

Almost 15 years after Morrison, courts still struggle to determine whether a securities transaction is domestic. In the meantime, as Williams v. Binance illustrates, the landscape has only become more involved and complicated given the dramatic rise in digital asset transactions.

Absent legislative reform, litigants and courts are left to apply existing law to products, activities and modes of transacting — tokens, mining, staking, blockchains, decentralized finance platforms, smart contracts, digital wallets — that would have been unimaginable to the Morrison court in 2010, let alone the New Deal-era drafters of the securities laws.

Time will tell whether courts can adapt and evolve to develop a workable means of applying Morrison to modern digital assets, but as of now, the forecast is as unpredictable as the framework.

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[1] Williams v. Binance, 96 F.4th 129 (2d Cir. 2024).

[2] Id. at 132-34.

[3] Morrison v. Nat'l Australia Bank Ltd., 561 U.S. 247, 270 (2010).

[4] See id. at 267.

[5] See id. at 260-61, 268. As a result of the 2010 Dodd-Frank Act, a version of the conduct-and-effects test continues to apply in actions brought by the Securities and Exchange Commission or Department of Justice. In such enforcement actions, the antifraud provisions apply when significant steps are taken in the United States to further a violation or conduct outside the United States has a foreseeable substantial effect within the United States. See SEC v. Scoville, 913 F.3d 1204, 1215 (10th Cir. 2019).

[6] See SEC v. Morrone, 997 F.3d 52, 60 (1st Cir. 2021); Stoyas v. Toshiba Corp., 896 F.3d 933, 949 (9th Cir. 2018); United States v. Georgiou, 777 F.3d 125, 137 (3d Cir. 2015); Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 62 (2d Cir. 2012); Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310-11 (11th Cir. 2011);

[7] Absolute Activist Value Master Fund Ltd., 677 F.3d at 62; see also Morrone, 997 F.3d at 60; Georgiou, 777 F.3d at 137; Stoyas, 896 F.3d at 949.

[8] Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings, 763 F.3d 198, 216 (2d Cir. 2014).

[9] See Morrone, 997 F.3d at 60; Stoyas, 896 F.3d at 950.

[10] Stoyas, 896 F.3d at 950.

[11] Morrone, 997 F.3d 60-61.

[12] Cavello Bay Reinsurance Ltd. v. Shubin Stein, 986 F.3d 161, 165 (2d Cir. 2021).

[13] Id. at 165.

[14] Anderson v. Binance, 1:20-cv-2803, 2022 WL 976824, at *4 (S.D.N.Y. Mar. 31, 2022) rev'd sub nom Williams v. Binance, 96 F.4th 129 (2d Cir. 2024).

[15] Williams, 96 F.4th at 137.

[16] Id. at 139.

[17] See id. at 140.

[18] Id. at 140.

[19] Daramola v. Oracle Am. Inc., 92 F.4th 833, 842-43 (9th Cir. 2024).