It Begins: The First ICO-Related Securities Litigation Has Been Filed – and There are Lessons in it for Those Hoping to File Their Own ICO

Nov 15, 2017

Categories:

Blockchain and Digital Assets
Blogs

Authors:

John S. Wagster
Courtney Rogers Perrin

On October 25, 2017, Plaintiff, Andrew Baker filed a proposed class action against Dynamic Ledger Solutions, Inc. ("DLS") and several other related entities ("Defendants") regarding an initial coin offering ("ICO") for tokens known as "Tezzies." While time and the courts will determine the merits of the class action, given the increasing popularity of ICOs, there are lessons to be learned from the accusations, both for aspiring ICOs and potential investors.

What are Tezzies?

Tezzies are the token related to the Tezos blockchain. According to the Tezos overview document, the Tezos blockchain would facilitate formal verification of smart contracts by mathematically proving the correctness of the code governing transactions.[1] The network would launch in summer 2017.

Tokens procured from the ICO could be used to power smart contracts in the network and to vote on protocol amendments. The number of tokens issued in the ICO was uncapped. Depending on the funds received in the ICO, the Tezos Foundation (one of the Defendants) would take certain development steps, as laid out in the overview document.

What is the Tezzie Suit About?

The complaint alleges that the Defendants launched an ICO in July 2017, which resulted in the sale of over 607 million Tezzies or "XTZ". In exchange, Defendants received digital currency worth about $232 million (now worth approximately $475 million, according to the Plaintiff).

Plaintiff purchased 5,000 Tezzies in exchange for one Bitcoin (then valued at approximately $2,800). Plaintiff alleges that:

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

- Tezzies derive their value from the usefulness and the popularity of the Tezos network. Plaintiff asserts that the Tezos network was projected to launch no later than December of 2017, but now the goal is February 2018.
- None of the development steps laid out in the overview document have been met, despite the ICO raising more than 10 times the funds set forth in the most top-end scenario.
- Though the ICO's "purported terms" referred to the purchase of a Tezzie as a "non-refundable donation" instead of a "speculative investment," Plaintiff was never shown these terms at any stage during the ICO process and did not agree to them. Moreover, Plaintiff asserts that the characterization as a donation is refuted by "significant investments made by cryptocurrency hedge funds."

Plaintiff further alleges the Defendants:

- Failed to register the offer and sale of securities in violation of federal securities laws;
- Committed fraud in the offering or sale of securities in violation of federal securities laws;
- Committed false advertising in violation of California statutory law;
- Engaged in unfair competition in violation of California statutory law; and
- Acted as alter-egos of one another and all actions could be imputed to each Defendant separately or to all Defendants severally. Plaintiff seeks restitution and disgorgement of gains, rescission of the purchases of Tezzies, and punitive damages, among other relief.

How Does the Tezzie Suit Related to SEC Guidance?

The Securities and Exchange Commission (the "SEC") recently issued two pieces of guidance related to ICOs: its DAO report and an Investor Bulletin.

The DAO Report noted that whether virtual coins or tokens qualify as securities is a fact-specific inquiry (discussed more here). The key question is how the future value of the token is determined; if it

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

is tied to the promoter's efforts, it likely will be considered a security. Such linkage could be established by a showing that the token is worthless until future development occurs or if a promised dividend stream exists.

The Investor Bulletin provided practical advice for ICO promoters and participants (discussed more here). As to promoters, the SEC's guidance suggests that wide-ranging risk factors, such as those asserting a diminished ability to recover under federal securities laws in the event of fraud or theft, may be appropriate.

The Tezzie complaint appears to align neatly with the SEC's guidance. The complaint alleges that the token's value was related to future development and that no risk factors were included in any of the ICO materials – two factors mentioned in the DAO Report and the Investor Bulletin.

What Steps Should a Promoter Take to Protect Itself?

As formal guidance is issued from the SEC and informal, practical guidance arises from litigation, promoters are starting to gain a bit of clarity on best practices. As the ICO market matures, participants and investors are becoming more sophisticated. While nothing fully insulates a promoter from litigation or a regulatory action, the following may be helpful:

- **Hire qualified advisors.** It's hard to find legal and accounting counsel that has advised on ICO launches. Make sure whomever you hire has done so and is familiar with the issues relevant to your token. Securities, commodities, BAS/AML/KYC and money transmitter analyses are essential to every offering. Jurisdictional and tax issues are equally important, particularly for ICOs filing in foreign jurisdictions.
- **Ensure any promises made are met.** The Tezzie complaint specifically alleges that Defendants made many promises, both in the white paper and in other materials, and have failed to keep such promises. Statements of fact must be qualified, estimated returns must be described as aspirational, and hyperbole must be stricken. It's better to under-promise and over-deliver.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

- **Have a clear business plan.** Sophisticated investors will insist on a meaningful business plan, which should include a budget and reasonably achievable goals. The budget should sync with any revenue cap set on the token's issuance, and the use of proceeds should be described in reasonable detail.
- **Incorporate robust risk factors into your materials.** The SEC's Investor Bulletin provided some clear language, but experienced counsel will have many more to add. Relevant risk factors are an essential element in any ICO, and failing to list them can leave issuers open to claims from investors, as well as the SEC. The Tezzie complaint alleges no risk factors were included whatsoever.
- **Follow Start-Up Business Fundamentals.** In addition to complying with applicable laws and avoiding regulatory hurdles, successful ICOs should follow the same commonsense business fundamentals one would expect to see in any start-up. In addition to a good business plan, ICOs need to make certain all users of their proposed tokens are properly incented to use the token and encourage others to do so.

If you are planning to launch an ICO or have questions about this article, please contact John Wagster or Courtney Rogers Perrin, members of the Blockchain and Digital Currency group at Frost Brown Todd.

Note: No information in this article should be taken as legal advice, specifically with respect to any matters pertaining to California law.

[1] For more information about the Tezos blockchain, please refer to the position paper and the white paper, which describes Tezos as "a generic and self-amending crypto-ledger" which "aims to be the *last* cryptocurrency."

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons