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1 UNITED STATES DISTRICT COURT  
2 SOUTHERN DISTRICT OF NEW YORK

3 -----x  
4 SECURITIES AND EXCHANGE  
5 COMMISSION,

6 Plaintiff,

7 v.

19 CV 9439 (PKC)

8 TELEGRAM GROUP, INC., et al.,

9 Defendants.  
10 -----x

11 New York, N.Y.  
12 February 19, 2020  
13 10:01 a.m.

14 Before:

15 HON. P. KEVIN CASTEL,

16 District Judge

17 APPEARANCES

18 SECURITIES AND EXCHANGE COMMISSION

Attorneys for Plaintiff

19 BY: KEVIN McGRATH  
20 JORGE TENREIRO  
21 ALISON R. LEVINE  
22 LADAN F. STEWART

23 SKADDEN, ARPS, SLATE, MEAGHER & FLOM

Attorneys for Defendants

24 BY: ALEXANDER DRYLEWSKI  
25 SCOTT MUSOFF  
CHRISTOPHER MALLOY  
THANIA CHARMANI

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1 (Case called)

2 MR. TENREIRO: Good morning, your Honor.

3 Jorge Tenreiro on behalf of the U.S. Securities and  
4 Exchange Commission.

5 MR. McGRATH: Good morning, your Honor. Kevin  
6 McGrath.

7 MS. LEVINE: Good morning, your Honor. Alison Levine.

8 MS. STEWART: Good morning. Ladan Stewart.

9 THE COURT: You're all also from the plaintiff, right?

10 MS. STEWART: Correct.

11 THE COURT: For the defendant.

12 MR. DRYLEWSKI: Good morning, your Honor. Alex  
13 Drylewski, Scott Musoff, Christopher Malloy and Thania Charmani  
14 from Skadden Arps on behalf of the defendants.

15 THE COURT: Good to see you all.

16 Mr. Musoff, good to have you back in my courtroom.

17 MR. MUSOFF: Thank you, your Honor. My pleasure.

18 THE COURT: We still have some unfinished business.

19 MR. MUSOFF: We're getting closer, your Honor.

20 THE COURT: That's good to hear.

21 First order of business is the evidentiary record on  
22 the motion for preliminary injunction. Does the plaintiff wish  
23 to offer any live testimony?

24 MR. TENREIRO: Not at this time, your Honor.

25 THE COURT: All right.

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1           And you have submitted additional exhibits, documents,  
2 I think excerpts from Mr. Hyman's deposition and now you have  
3 some materials produced in foreign countries, I understand,  
4 that you're offering at this time.

5           MR. TENREIRO: That is correct, your Honor. We're  
6 offering those and the summary judgment exhibits as well.

7           THE COURT: Now when you say the "summary judgment  
8 exhibits," what specifically do you mean by that? That which  
9 you have referenced in your Rule 56.1 statements? Is that what  
10 you mean? You're offering all of that in support of your  
11 motion for preliminary injunction, right?

12          MR. TENREIRO: That's correct, your Honor, yes.

13          THE COURT: And let me hear from Mr. Drylewski.  
14 You, I gather, are opposing the Hyman testimony. I've  
15 given you the opportunity to crossdesignate. Why do you oppose  
16 the introduction of the Hyman testimony?

17          MR. DRYLEWSKI: We don't oppose the introduction of  
18 it, your Honor. Aside from our objections to relevance, once  
19 we put in the counterdesignations, we don't object.

20          THE COURT: That's taken care of. Thank you.  
21 Does the defendant have any live testimony they wish  
22 to offer?

23          MR. DRYLEWSKI: No, your Honor.

24          THE COURT: And you're relying on the exhibits  
25 referenced in your 56.1 statement. Anything else that I should

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1 know you're relying on of an evidentiary nature?

2 MR. DRYLEWSKI: No, your Honor.

3 THE COURT: So, the evidentiary record in this case is  
4 closed.

5 MR. DRYLEWSKI: That's correct.

6 THE COURT: All right. A few observations. There  
7 are, of course, a number of motions pending. There is the  
8 12(f) motion. There are the parties' various motions for  
9 summary judgment. And, of course, the plaintiffs' motion for a  
10 preliminary injunction. I'm going to hear argument from each  
11 of you this morning. I wanted to make a couple of preliminary  
12 observations because it may help and guide your discussion  
13 here.

14 In terms of first principles, the *Howey* Test has been  
15 with us for over 70 years, longer than many of the people at  
16 the first two tables have been alive, and cryptocurrency has  
17 been around for about twelve years.

18 One of the issues that is not presented in this case  
19 and that no one has argued that cryptocurrencies are inherently  
20 securities. That's not what this case is about. In fact,  
21 there would be no basis under the *Howey* Test for such an  
22 argument.

23 I've read carefully the amicus submissions of our two  
24 amicus curiae that I have already approved, or amici I should  
25 say, and that is not what this Court will be deciding.

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1           *Howey* is easy to state, maybe not always easy to  
2 apply, but an investment contract is a security within the  
3 meaning of the Securities Act of '33 if it's a contract,  
4 transaction or scheme whereby a person: One, invests money;  
5 two, in a common enterprise; three, is led to expect profits;  
6 and four -- well *Howey* says solely from the efforts of the  
7 promoter or third party but as time has gone on that "solely"  
8 language has been modified and it's not a literal limitation.  
9 It's a primarily promoted or -- that seems to be the most  
10 prevalent matter in which it is utilized.

11           And, of course, *Howey* is a flexible test. It focuses  
12 on economic realities, not on labels. And, of course, the  
13 lawyers in this case are well acquainted that the label point,  
14 that labels don't control, actually works in both directions.  
15 So you have the Forman case where stock in a corporation was  
16 held not to be a security because it was essentially ownership  
17 of a cooperative apartment. So the labels do not get anybody  
18 out of this one way or the other.

19           Disclaimers do not control. And so one can look at a  
20 purchase agreement and there could be a  
21 helpful-to-the-defendants statement or an unhelpful statement  
22 to the defendant in the purchase agreement or elsewhere and  
23 it's going to be the economic realities of the transaction that  
24 control.

25           The most notable difference in viewpoint as I see it

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1 between what the SEC is arguing and what the defendants are  
2 arguing is: What is the offering of a security? There is no  
3 dispute that there is or has been an offering of a security.  
4 The plaintiffs contend that. The defendants admit that.

5 In the plaintiff's view of the world that there is a  
6 connected scheme to have the two tranches or rounds of purchase  
7 agreements and that the intent and purpose of the purchasers as  
8 known to Telegram and as intended by Telegram was to not  
9 utilize the Grams received as a utility or for consumptive  
10 purposes but rather for the purpose of further distribution in  
11 a secondary market and these initial purchasers are either  
12 literally underwriters or akin to underwriters into that  
13 secondary market; that you look at whether it's a security at  
14 the time the purchase agreements are entered into, looking down  
15 the road at what the entirety of the scheme or transaction is.

16 The defendants see something very different or notably  
17 different in that they see the security which they assert is  
18 exempt under Reg D as a private placement. May also be Reg S  
19 also, I'm not sure. But they see that as a private placement  
20 of securities and it comes to rest at the instant of launch.  
21 And they maintain that at the instant -- (pause).

22 I have a deliberating jury, ladies and gentlemen. I  
23 have a note from them. If you could get everyone assembled.  
24 It appears to be some sort of a medical issue. Is the nurse  
25 in?

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1 THE DEPUTY CLERK: The nurse?

2 THE COURT: The nurse.

3 THE DEPUTY CLERK: Our nurse? I think they are.

4 THE COURT: See whether they are.

5 The defendants maintain that at the moment of launch  
6 there is a decentralized blockchain that will go into full  
7 operation; that it is ready to operate at the instant of  
8 launch; and that this will be a decentralized market, there  
9 will not be a common enterprise, and certainly it will not be  
10 from the efforts of the promoter at the moment of launch.

11 So there's a disagreement as to when does the court  
12 look at this transaction, at the moment of launch or at the  
13 moment the purchase agreements are entered into.

14 The SEC appears to take a fallback position that if  
15 one were to examine this at the moment of launch they maintain  
16 that it would still be a security under the *Howey* Test. And  
17 among the things we're going to look at -- Jeff, could you have  
18 the marshal come in. I want to talk to him.

19 One of the things we are going to consider is if, for  
20 example, our promoter in this case, Telegram Group and its  
21 senior team were to depart the scene and return to the British  
22 Virgin Islands at the time the purchase agreements were entered  
23 into, could this have survived and, again, even at the moment  
24 of launch if they departed the scene and exited and did nothing  
25 further, could this survive.

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1 Now, ladies and gentlemen if you take one moment.

2 (Pause)

3 (Court and marshal confer)

4 So, those are some of the issues we're going to talk  
5 about. I expect the parties to address what the economic  
6 justification was for the lockup in the round one purchase  
7 agreements, whether this transaction and the distribution to  
8 the initial purchasers was for a consumptive purpose on the  
9 part of the initial purchasers, is that even an important  
10 question, and what the business justification was on the part  
11 of the purchasers for tying up capital for a year or more due  
12 to lockups and delays in getting the blockchain up if this was  
13 just a currency. All right.

14 And so with that we'll begin with the government.

15 Mr. Li, I'm tasking you with letting me know when  
16 defense counsel arrives, OK. Thank you.

17 MR. LI: Yes, your Honor.

18 MR. DRYLEWSKI: Your Honor if I could before we begin  
19 just a small housekeeping matter.

20 THE COURT: Sure.

21 MR. DRYLEWSKI: Before we get into the substantive  
22 discussions here, given the nature of the discussions, we  
23 thought it may be helpful to the court reporter. We put  
24 together a glossary of terms and spellings. We gave a copy to  
25 the SEC with the Court's permission we would hand this to the

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1 court reporter.

2 THE COURT: Thank you.

3 So whenever you're ready, Mr. Tenreiro.

4 MR. TENREIRO: Thank you.

5 Good morning again, your Honor. May it please the  
6 Court. As the Court recognized, we are here most importantly  
7 to ensure that we stop what is an ongoing violation of Section  
8 5 of the Securities Act, the registration requirement which is  
9 the critical bedrock component of the United States securities  
10 laws.

11 Hundreds of businesses register every year with the  
12 SEC. The core issue in this case is whether Telegram sold  
13 securities and, if so, whether it was entitled to an exemption  
14 from the registration requirement.

15 The Court is correct to focus under *Howey* on the  
16 economic reality. The economic reality of what occurred here  
17 really is beyond dispute, your Honor. We submit that this was  
18 a straightforward capital raise by a startup company.

19 Telegram, as the record shows, needed money to fund  
20 the growth of its popular messaging app and projects that it  
21 was putting out there into the market. Now, having raised some  
22 of those funds, it seeks to obtain the benefit of the funds  
23 that will come indirectly from public investors through the  
24 underwriters without the responsibilities and obligations that  
25 come with registration.

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1 Telegram could have done this many other ways. But to  
2 remain competitive with WhatsApp it does not want to charge  
3 user fees and to keep its corporate ethos of privacy and no  
4 government regulation it doesn't want to sell a piece of its  
5 company as the CEO admitted under oath.

6 So what Telegram did was it hired investment bankers  
7 to find venture capitalists and other institutional investors  
8 to buy into this offering.

9 And it is also undisputed that Telegram did not even  
10 file a Form D as to this -- into the transactions until after  
11 it was contacted by the SEC.

12 I'd like to highlight for the Court three undisputed  
13 facts that go to the economic reality of what occurred here and  
14 that compel the conclusion that Telegram sold securities which  
15 included and include the Grams and that it is entitled to no  
16 exemption.

17 In addition to the fact that I mentioned, which is  
18 that Telegram was seeking to raise funds for its business  
19 through the use of investment bankers and venture capitalists,  
20 it cannot be disputed that Telegram did not condition delivery  
21 of Grams to venture capitalists under existing actual uses for  
22 Grams or on the echo system being developed to the point where  
23 one could reasonably expect that these sophisticated purchasers  
24 would view these as commodities.

25 As the Court alluded to just a moment ago, it's

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1 impossible to surmise any business justification for these  
2 sophisticated purchasers to tie up \$1.7 billion in funds simply  
3 because they wanted to convert it into another currency that  
4 they were going to use as currency.

5 It is equally --

6 THE COURT: But you can buy gold and not view it as a  
7 means to store value or to pay for something but to, if you  
8 will, speculate in gold, right?

9 And you could, in that sense, you could not be a  
10 security within the meaning of *Howey* and purchase a  
11 cryptocurrency for speculative purposes, correct?

12 MR. TENREIRO: That is correct, your Honor.

13 There is a number of differences with the gold  
14 example. One is the one the Court alluded to earlier which is  
15 that you typically don't tie in your funds for years on a  
16 purchase of gold in that nature -- in that fashion.

17 Another difference I think is that if my boss were to  
18 come into my office tomorrow and say I want you to sue gold I  
19 would say I don't know who to sue, I don't know who to serve  
20 the subpoena to.

21 THE COURT: Go ahead.

22 MR. TENREIRO: So for gold there is no promoter.  
23 There is nobody there that's saying this -- buy gold to  
24 speculate because I'm going to be -- I suppose the person who  
25 could do that would be God. God might say I'm going to create

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1 more gold and people are going to like it more. So that is the  
2 principal distinction between gold and an asset that requires  
3 Telegram -- Telegram's significant efforts, which they touted,  
4 to develop, before it achieved the moment where it could be  
5 used as quote/unquote gold.

6 The next fact I'd like to highlight for the Court is  
7 that Telegram, it is undisputed, that it's so-called investors  
8 have already begun their public distribution of Grams.  
9 Telegram does not and cannot dispute that from the moment of  
10 the presale round purchasers started reselling their right to  
11 receive Grams and up until at least the summer of 2019.

12 This demonstrates what the economic reality of this  
13 transaction was. People are already trying to profit from the  
14 speculative nature of their interest in --

15 THE COURT: This is the purported secondary market  
16 that's already emerged? Is that what you're referring to?

17 MR. TENREIRO: That is correct, your Honor.

18 THE COURT: One second.

19 MR. TENREIRO: Yes.

20 (Pause)

21 (Court and marshal confer)

22 THE COURT: Go ahead.

23 MR. TENREIRO: Thank you, your Honor.

24 The third undisputed point is another one that the  
25 Court alluded to in its introductory remarks. The economic

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1 justification for the lockups and price differentials -- I've  
2 never heard of somebody selling doughnuts to people and selling  
3 the same doughnuts to somebody for 37 cents and to other people  
4 for a dollar and 33 cents. What this -- the economic reality  
5 of the transaction, as Telegram structured it, created an  
6 incentive for resales to occur and for people to view this as a  
7 potential profit-making enterprise.

8 What will happen, the economic reality of this is that  
9 there's two rounds. The presale -- the so-called presale  
10 purchasers paid 37 cents per gram and have -- will have no --  
11 will have a relief -- I can call a delayed delivery or slow  
12 release date of how they can sell their Grams.

13 But from the beginning Telegram told the market, the  
14 people that it was marketing this offering to, that they were  
15 going to have subsequent rounds at higher prices with no  
16 lockups. So the so-called Stage A investors ultimately pay a  
17 dollar 33 cents, approximately four times as much. But they  
18 were told you're not going to have any lockups.

19 So what is going to happen? What is going to happen  
20 if and when these investors receive their Grams?

21 They know that waiting in the wings three months later  
22 there is going to be a market, a flood into the market at a  
23 quarter of the price. This creates a very strong economic  
24 incentive to sell the Grams. You'd be foolish not to try to  
25 divest yourself before those three months are up because in

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1 three months somebody else can make a profit at a much lower  
2 price.

3 These facts, your Honor, establish -- Telegram cannot  
4 dispute any of these facts. Telegram relies mostly on  
5 disclaimers and, as the Court recognized, disclaimers are not  
6 what the Court looks to in the *Howey* Test. For every  
7 disclaimer that Telegram points to one can point to another  
8 disclaimer that goes the other way.

9 The economic reality of the transaction is that this  
10 was a capital fund raise in the offering sale of securities in  
11 2018. Telegram could have structured its offering in other  
12 ways that would have complied with the securities laws. But  
13 Telegram chose to invoke the jurisdiction of the SEC by  
14 claiming a Regulation D exemption and now having failed to  
15 comply Telegram should be enjoined from carrying out the next  
16 unlawful step in that distribution.

17 THE COURT: And the reason they flunk Reg D is because  
18 the initial purchases are, in your view, underwriters. Is that  
19 the reason they flunk? Or is there some other reason?

20 MR. TENREIRO: There's a number of reasons, your  
21 Honor. I think the Court alluded to one of them. They don't  
22 have to be -- they can be akin to underwriters. I think the  
23 Second Circuit has recognized a number of times not only that  
24 it's a broad term but that, in fact, anyone taking steps  
25 necessary to effect the distribution are -- can be considered

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1 underwriters.

2 But there's a number of other reasons and I'll go  
3 through them.

4 The first one is something we've been discussing  
5 already which is that Telegram put no restrictions on reselling  
6 by the Stage A investors. So in a private offering, in a  
7 private offering done --

8 THE COURT: When you use the term Stage A, it's  
9 synonymous with round two purchasers, correct?

10 MR. TENREIRO: Yes, your Honor. That's correct.

11 THE COURT: And presale is synonymous with round one?

12 MR. TENREIRO: That's right.

13 THE COURT: Thank you.

14 MR. TENREIRO: So the other fact that shows that the  
15 Regulation D exemption was not met is that it's undisputed that  
16 initial purchasers are already selling the right to receive  
17 Grams into an existing secondary market that Telegram  
18 encouraged.

19 THE COURT: I thought -- I may be wrong about this but  
20 I thought that purchase agreements prohibited purchasers from  
21 selling into a prelaunch market.

22 MR. TENREIRO: That is correct, your Honor.

23 But the Second Circuit and the SEC have long  
24 recognized -- I think one example is the Cavanaugh case from  
25 the 1990s -- that sort of just taking the underwriters at their

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1 word is not sufficient. The burden of meeting Regulation D is  
2 on the issuer. And the exemption is construed narrowly to  
3 effect the purposes of the securities laws. So for them to  
4 say -- promise us that you're not going to resell is not  
5 enough.

6 THE COURT: Well do you take the position that Reg D  
7 is not available because this is an offering to those who will  
8 purchase in the postlaunch secondary market and they will be  
9 purchasing without the benefit of a registration statement or  
10 qualifying under the qualified investor standards and the like?

11 MR. TENREIRO: That's right. That is correct, your  
12 Honor. This is a public offering. The Court should view this  
13 as one transaction.

14 We are in the perhaps somewhat unique position of  
15 standing here in the middle of it and asking the Court to  
16 enjoin the ongoing violation. But the Court is correct that  
17 that is how we view it.

18 Other facts that are undisputed that show that  
19 Telegram as a matter of law cannot meet Regulation D is that  
20 Telegram paid initial purchasers transaction-based  
21 compensation, reselling the right to receive Grams.

22 THE COURT: Why does that -- how does that factor in  
23 and why is that relevant?

24 MR. TENREIRO: So typically in a Regulation D offering  
25 that's done correctly the issuer knows who it's selling the

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1 instrument to because the issuer has an obligation to make sure  
2 that the individuals are accredited investors there's a long  
3 list of requirements including accredited investors, that  
4 they're not certain individuals that are sanctioned and things  
5 of that nature.

6 In this case Telegram cannot today tell a Court who  
7 the ultimate beneficiaries are of all the sales that it entered  
8 into because what happened and what's undisputed in the record  
9 is that after March 2018 Telegram lost control of its offering.  
10 A number of the market -- perhaps the market for  
11 cryptocurrencies had faced a downturn in early 2018. Telegram  
12 thought it had \$150 million lined up and it didn't. And it had  
13 to sort of scramble to replace purchase agreements. And it  
14 hired at least three entities to find other investors for them.  
15 And Telegram did not conduct KYC look-through all the way  
16 through to all of those ultimate beneficiaries. Telegram knew  
17 that some of these individuals -- some of these entities were,  
18 in fact, marketing Grams and making -- marketing them --  
19 issuing marketing materials.

20 THE COURT: For what you would view as the postlaunch  
21 distribution or was it prelaunch distribution? When you say  
22 marketing materials, as to what?

23 MR. TENREIRO: Those were used, as far as I can tell,  
24 for prelaunch. Now there could be evidentiary question as to  
25 whether those condition -- conditioned the future market. But

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1 we're saying now that those marketing materials were used to  
2 induce purchases during those initial, well call it the initial  
3 phases of the offering.

4 Most importantly, your Honor, as we've been discussing  
5 already, Telegram, as a matter of economic reality, Telegram  
6 told people they wanted to achieve widespread distribution of  
7 these instruments and sought out people who were going to buy  
8 for that purpose.

9 The analogy I would point the Court to is the  
10 Aqua-Sonic case from the Second Circuit where the issuer was  
11 selling sort of dental licensing agreements. And in construing  
12 the *Howey* Test the Second Circuit said the promoter didn't find  
13 people who knew how to use dental licensing agreements, didn't  
14 even hire salesmen that knew what these agreements were about.  
15 They found people to sell investments.

16 That's what Telegram did here.

17 THE COURT: What's your evidence that in recruiting  
18 purchasers in round one presale or round two Stage A Telegram  
19 was seeking people who could distribute or would distribute the  
20 Grams postlaunch or prelaunch?

21 MR. TENREIRO: Right. I think the evidence -- there's  
22 a number of factors that I would point the Court to critically.  
23 The affidavits that we submitted from the Court show -- and I  
24 don't think Telegram disputes -- that nobody asked the venture  
25 capitalists and other sophisticated purchasers: Do you have

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1 any use for cryptocurrencies? Are you planning on using Grams  
2 on -- what's one of the apps that they put in the list, a  
3 pregnancy app. I don't think that that question was asked of  
4 any of the venture capitalists.

5 THE COURT: But again going back to the gold analogy,  
6 I got a big pile of gold and people -- I'm seeking out people  
7 to buy gold. I'm not asking them what they plan to do with it.

8 Maybe they're going to mint it into coins and sell it.  
9 I don't know.

10 MR. TENREIRO: And the gold analogy, your Honor, is  
11 tempting but it fails because labels don't control. And gold  
12 has intrinsic value today. Grams have -- do not have intrinsic  
13 value; that it's not tied to the efforts and the promises of  
14 efforts that Telegram made.

15 I think an important -- I would like to point the  
16 Court to the undisputed facts that none of these individuals  
17 were even asked whether they had any interest in  
18 cryptocurrencies. One could, for example, think of a situation  
19 where who uses cryptocurrencies? Sometimes you hear that  
20 people who are in countries that maybe don't have as well  
21 developed banking systems, or people that have more restricted  
22 banking systems. So if Telegram had sold Grams to those  
23 individuals, I suppose it would have a better argument that it  
24 was selling cryptocurrencies to sell.

25 Telegram is going to talk about theater tickets but

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1 Telegram didn't look for theater fans when it was selling these  
2 things. Telegram was looking to people who are in the business  
3 of funding venture capital ventures, of funding businesses.

4 I think one of the investment memos I think most well  
5 crystallizes this point is PX 30, Exhibit 30, one of the  
6 exhibits we submitted. And that investment memorandum captures  
7 the economic reality of this transaction from start to finish.  
8 In the very first page the investor talks about the potential  
9 for annualized returns of 180 percent to early investors.

10 At page four of that investment memorandum the  
11 investors say, "We firmly believe the Durov brothers will be  
12 the guiding force," the Durov brothers, and particularly Pavel,  
13 will be the guiding force behind time.

14 Later in the investment memo the investor notes the  
15 economic reality of this transaction, which is that Telegram is  
16 free to use and has no way to monetize. They pride themselves  
17 on offering free fast messaging services and currently operate  
18 as a nonprofit. This is from page nine. The introduction of  
19 TON blotching architecture.

20 THE COURT: Are you talking about internal page nine  
21 or the file page nine? I guess the internal page nine.

22 MR. TENREIRO: Internal page nine would be file page  
23 ten.

24 THE COURT: And when? Under what?

25 MR. TENREIRO: Under TON Valuation Revenue Capture.

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1 THE COURT: OK. This is going to not take very long  
2 but I have a matter to tend to in my criminal case and then  
3 we'll pick up.

4 So I'm estimating about seven minutes, something like  
5 that.

6 MR. TENREIRO: Thank you, your Honor.

7 THE COURT: And I can see the attorneys and the  
8 defendant at sidebar. So, Flo, if you'll bring them in for  
9 sidebar.

10 (Recess)

11 THE COURT: I'm sorry, Mr. Tenreiro.

12 MR. TENREIRO: May I proceed, your Honor?

13 THE COURT: Yes.

14 MR. TENREIRO: Thank you, your Honor.

15 THE COURT: So we were looking at PX 30.

16 MR. TENREIRO: That's right. And we were focusing on  
17 page 9, internal page 9. And, as I was saying, I think that  
18 this investment memorandum captures very well the economic  
19 reality as all of these highly sophisticated and experienced  
20 investors understood it. I think Telegram wants to tell the  
21 Court that it should not look to the views of the investors  
22 because *Howey* is an objective test. *Howey* is of course an  
23 objective test. But the Second Circuit has repeatedly cited  
24 with approval in Glen-Arden and in Acqua-Sonic and said we look  
25 at what the people actually did to inform that objective

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1 reality.

2 If Telegram were to bring in space investments into  
3 the Court tomorrow to say these are oranges, one might question  
4 whether there's an objective -- that feeds into the objective  
5 test and whether the Court should give any weight to that.

6 But these were documents created internally by these  
7 investors who have now also, some of them, come to the Court  
8 with sworn declarations explaining some of the points that I've  
9 made, including that none of them -- nobody has asked them what  
10 they wanted to do with these but, more importantly, that they  
11 bought these for profit and not use and that they expect  
12 Telegram to work on this project postlaunch based on the  
13 statements that Telegram made to them.

14 One example is PX2. Paragraph 14. The investor  
15 explains that to the Court. PX3, in paragraphs 18 to 22, the  
16 same explanation.

17 I don't want to go through all of them necessarily.  
18 They are in our briefs. But I think that the unifying theme  
19 and the thread that sort of binds these affidavits and that is  
20 consistent with the investment memos at the time is that the  
21 economic reality of this transaction is as we've been  
22 describing it to the Court this morning.

23 The important thing, as one can see from all of these  
24 investment memorandums, the investors' expectations of how much  
25 profits they could make. They talked about 40X, return 10X on

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1 our investment, upside is 3 to 4X. Those are some examples.  
2 That's not what people talk about when they're discussing  
3 investing in oranges. This is what people talk about when they  
4 are funding a company and they're hoping to profit from the  
5 efforts of that company to be successful in the endeavors the  
6 company has promised.

7 Telegram would also have the Court look only to the  
8 four corners of the purchase agreement. And I think that it  
9 really cannot be disputed that that's simply incorrect as a  
10 matter of law.

11 Recently in the case U.S. v. Leonard in the Second  
12 Circuit, which is also cited in our papers, the Second Circuit  
13 reminded lower courts that it should look beyond just the terms  
14 of the agreement. In fact, there's a line in there that says:  
15 Were we to look only at the agreements, and some conclusion  
16 follows, but the court explicitly reminds the courts what has  
17 been clear since *Howey*, which is that when we're talking about  
18 investment contract, we're talking not about the instruments  
19 and not about the labels but, as this court has recognized  
20 today, the economic reality and all of the representations  
21 made.

22 Telegram in the white paper that it admits that it  
23 published in March of 2019 to the market at large, but that it  
24 also has stipulated it distributed to the initial purchasers  
25 during the fundraise that we're discussing, makes statements

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1 such as the TON Foundation itself will likely have to provide  
2 most of the validators during the first appointment phase of  
3 the TON blockchain. That's at page 130 of the white paper.

4 At page 31 Telegram said that the TON Foundation will  
5 be receiving the money or the cryptocurrency or fiat  
6 currency -- I'm paraphrasing now -- that it will obtain from  
7 selling Grams and that it will use them to further the TON  
8 project. That is what Telegram told people it was going to do.  
9 And that is what people understood Telegram to be offering  
10 them.

11 THE COURT: Well, how do you respond to I think it's  
12 Exhibit 2, the McKeon, where he has a list of potential  
13 validators who will step up to the plate?

14 MR. TENREIRO: So the fact that there might be other  
15 validators that might essentially validate transactions, your  
16 Honor, is not -- is neither relevant nor dispositive.

17 The question under *Howey* is: What can a reasonable  
18 purchaser expect Telegram's role to be based on the economic  
19 reality of undisputed facts?

20 And one economic factor that's undisputed is that  
21 Telegram will have sort of the legal right to control  
22 42 percent of the Grams even after the launch.

23 THE COURT: And what can you tell me about the  
24 connection between the named defendants and the TON Foundation  
25 which I gather it now exists, right?

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1 MR. TENREIRO: It's -- I don't think so, your Honor.  
2 I think the TON Foundation has not yet been established.

3 THE COURT: OK.

4 MR. TENREIRO: Part of the difficulty in answering the  
5 Court's question is that Telegram has maintained from the very  
6 beginning that it has flexibility to do whatever it wants. And  
7 that -- and so that factor really cannot be something that the  
8 Court can reasonably and logically consider when it considers  
9 the economic reality.

10 THE COURT: But the evidence you maintain, and you  
11 maybe can point me in that, direction is that the two -- one or  
12 the other of the two named defendants will establish the  
13 foundation that will hold 52 percent or so of the Grams.

14 MR. TENREIRO: So what Telegram told people at the  
15 time that it entered into the purchase agreements is that it  
16 will do that and that the TON Foundation, this is page 130 of  
17 the white paper, the TON Foundation itself will likely have to  
18 provide most of the validators during the first appointment  
19 phase of the TON blockchain; and then it says i.e., its  
20 creators, the development team. So that's the evidence of what  
21 was said to people at the time.

22 I expect Mr. Drylewski to say well Telegram has sort  
23 of disclaimed. But what's important to note about these  
24 disclaimers is -- there's a number of things. First is, as the  
25 Court recognized, as a matter of law, disclaimers don't get you

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1 very far.

2 THE COURT: And some of these disclaimers are after  
3 the lawsuit was filed here.

4 MR. TENREIRO: And they're equivocal.

5 THE COURT: They were after the lawsuit was filed.

6 MR. TENREIRO: That's correct, your Honor.

7 THE COURT: Thank you.

8 MR. TENREIRO: They were. And they were equivocal.  
9 They are equivocal. Telegram does not actually commit to not  
10 establishing the TON Foundation. Telegram does not commit to  
11 not holding the Grams. Telegram says: We may; we may not.

12 But this gets me back to one of the questions that the  
13 Court posed to the parties at the beginning which is: At what  
14 time should the Court look at the transaction?

15 The law is clear, your Honor, and under -- and I'll go  
16 through it, that the time at issue here is when Telegram was  
17 offering and selling the securities.

18 If the Court were to construe Section 5 in any other  
19 way, it would create an incentive essentially to violate  
20 Section 5 by offering A today and telling you B tomorrow.

21 But the economic reality of the transaction does not  
22 really permit that. The economic reality of the transaction  
23 has not changed in the minds of the initial purchasers simply  
24 by Telegram's disclaimers. Telegram has made the efforts and  
25 since the filing of the lawsuit has, in fact, continued to make

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1 efforts.

2 THE COURT: Have you been able to establish whether or  
3 not 1.7 billion was, in fact, transferred in the two tranches?  
4 There's a flavor in the papers that maybe some of it hasn't  
5 been paid. And what is the significance of that, if any?

6 MR. TENREIRO: Thank you, your Honor.

7 So I think -- I think our understanding of the bank  
8 records, to the extent we have some, is that they eventually  
9 did get \$1.7 billion. But the timing of that is -- remains  
10 unclear to us.

11 I think the significance of that goes back to what I  
12 was discussing earlier with respect to the steps that Telegram  
13 took to complete its offering and how it conducted the offering  
14 which we maintain as a matter of law did not comply with  
15 Regulation D because of how it carried it out in addition to  
16 the factors about the economic reality of what the incentives  
17 were.

18 To go back to the point of the timing at which the  
19 point -- at which the Court looks at *Howey*. I think there's a  
20 number of legal doctrines that sort of inform this question.  
21 But the most basic one is simply the text of the law. The law  
22 speaks of offers and sales of securities.

23 The offers, indisputably, occurred when Telegram was  
24 marketing. It was offering the -- when offering the  
25 transaction. The sales, Telegram does not really say that the

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1 delivery is the sale. They don't actually go and say that.  
2 They are just saying that the delivery is the time of analysis  
3 based on no legal principle that I have been able to surmise.

4 And the Second Circuit has said in an unbroken line of  
5 cases that the word "sale" means the time the parties entered  
6 into the agreement. The moment the check was written --

7 THE COURT: And what's your legal support for that  
8 proposition? What cases are you relying on?

9 MR. TENREIRO: I would point the Court to Radiation  
10 Dynamics in the first place. But, as I mentioned, there is an  
11 unbroken line of cases. So we would also point the Court to  
12 Finkel v. Stratton, the 1992 case that extends the holding of  
13 Radiation Dynamics to the Securities Act itself.

14 And by the way, your Honor, the SEC has, in 2005, sort  
15 of issued guidance, which we cite in footnote nine of our  
16 motion for summary judgment, that is consistent with this, what  
17 I would argue as the only logical way to interpret Section 5.

18 The sale of stock in an IPO, typically there's a  
19 contract for delivery on day T plus 3. That Telegram decided  
20 to sort of interpose a piece of paper and say we'll deliver it  
21 at T plus 20 cannot change what was sold. I've sent my money  
22 to buy my bike and it's going to be delivered to me by Amazon  
23 over the mail. I bought it. I don't understand the  
24 significance of delivery, at least in the context of sale.

25 THE COURT: Well it might be one of those

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1 hold-for-Christmas sales.

2 MR. TENREIRO: It might be -- they used to call  
3 layaway.

4 THE COURT: Yes.

5 MR. TENREIRO: But if I pay for it, I bought it.

6 And that's the position, by the way, your Honor, that  
7 Telegram took in its Form D where it said we've sold 850  
8 million. They view themselves as having sold even though they  
9 haven't received all of the money.

10 That is the -- that is the economic reality that  
11 cannot be denied by this moment of delivery.

12 The delivery, your Honor, is a liquidity event. The  
13 launch of the blockchain is a liquidity event.

14 One of the questions the Court raised at the beginning  
15 was: Is there a dispute as to what the blockchain is going to  
16 look like. There is no question. I don't think we dispute  
17 that Telegram could, I think they said, within a five-second or  
18 five-minute notice launch this thing, which really suggests to  
19 us that a preliminary injunction is urgently required.

20 The question is whether Telegram can be expected to  
21 make efforts going forward; not whether it can launch, but  
22 whether it's still going to be involved.

23 THE COURT: Well I think it's your experts who  
24 question whether it could be viably launched in five minutes  
25 because of securities laws and the absence of security testing

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1 and a bunch of other things, the absence of any apps or known  
2 validators who are going to take this on, etc.

3 MR. TENREIRO: That's true, your Honor. But for  
4 purposes of our motion for preliminary injunction and summary  
5 judgment the Court may assume that Telegram is ready to launch.  
6 The question is what is it ready to launch.

7 But, as I said, that launch is simply a liquidity  
8 event. What is in the mind of the initial purchasers at the  
9 time of the agreement is what controls.

10 And if I may -- so we pointed the Court to what was in  
11 the mind of the initial purchasers. We've pointed the Court to  
12 the statements Telegram made at the time. The statements that  
13 I've covered from the white paper, some of them were repeated  
14 in the other marketing materials such as the primer, the  
15 presale primer where Telegram talked about its involvement  
16 through 2021 and where Telegram talked about the integration of  
17 Messenger into this echo system. All of these things, again,  
18 show up very clearly in the investment memoranda that were  
19 prepared at the time and that give the Court, one could say,  
20 clues or insight into what we submit is already the obvious  
21 economic reality of the transaction.

22 The Court asked at the beginning whether the  
23 transaction was for consumptive purpose or at least in part for  
24 that. There is no evidence in the record that that was the  
25 case. The evidence is all to the contrary. All of the

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1 investment memos and all of the affidavits talk about -- at  
2 most some say we've considered whether we'd act as validators.  
3 That's all that some of the investors have said. All of them  
4 have said, though, that they plan to find the right moment when  
5 to sell these things for a profit.

6 And I would like to point the Court back to the  
7 Gilligan, Will case from the Second Circuit which we think is  
8 critical in this case. In Gilligan, Will the Second Circuit  
9 said that's exactly the situation where we need registration  
10 and protection. These underwriters are going to decide what  
11 the right moment is to unload the securities onto members of  
12 the public. That's why we need registration and that's why we  
13 need information.

14 Because the underwriters are going to decide that this  
15 is no longer a worthwhile endeavor for them and dump the  
16 securities into the market. And that's what is at the core of  
17 the registration requirement, the Supreme Court's concerns  
18 since Ralston Purina and the cases that talk about a public  
19 distribution and how the Court should understand that issue.

20 I could address our motion our or 12(f) motion now or  
21 wait until.

22 THE COURT: No. I think what would be useful for you  
23 to do is -- and I understand the 12(f) motion and the  
24 opposition in the 12(f) motion.

25 Most of what I have experienced in terms of SEC

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1 enforcement actions are looking in some form of the rearview  
2 mirror, looking at likelihood of recurrence, etc. And there's  
3 a flavor of that standard in the defendant's papers. But what  
4 is the standard on irreparable injury in an alleged ongoing  
5 violation case?

6 (Continued on next page)

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1 MR. TENREIRO: Thank you, your Honor.

2 I'll address that. So, I think again it's important  
3 to start with the text of the statute. The statute Section  
4 20(b) if I may bring my statute book.

5 THE COURT: Sure.

6 MR. TENREIRO: Section 20(b) of the Securities Act is  
7 clear that whenever it shall appear to the commission that any  
8 person is engaged or is about to engage in any acts or  
9 practices which constitute or will constitute a violation of  
10 these provisions, it may bring -- now I'm phrasing -- it may  
11 bring essentially an injunctive action and it empowers the  
12 courts to enjoin such acts or practices.

13 So, that's sort of the traditionally language that one  
14 looks to for what's called a 'prospective injunction'. And the  
15 standard, we submit, the standard is there a violation that's  
16 ongoing? So, to meet that standard we have to prove, as we  
17 submit that we have, that the violation occurred and that it's  
18 continuing. I don't think there is any dispute that if this  
19 case were to go away Telegram would within five seconds or five  
20 minutes is going to press the 'send' button and distribute  
21 these securities to the initial purchasers. We submit that  
22 that's the next step within this offering, that's a public  
23 offering in violation of Section Five.

24 To the extent that the SEC, as the Court obviously  
25 knows, that the SEC doesn't have to prove irreparable injury in

1 the typical forward looking injunction when there's been a  
2 completed violation. Those cases talk typically about a  
3 preliminary obey the law injunction, a broad obey the law  
4 Section Five or Section 10 injunction. To the extent that --  
5 so, we submit that we do not have to show irreparable injury  
6 but I think that in the context of a prospective injunction,  
7 that's exactly what we're here to stop which is an injury to  
8 the public by having securities distributed without the  
9 registration statement being provided by Telegram and the  
10 information that's in that registration statement.

11 As the Court knows from its experience, those  
12 registration statements have disclosures about risks, about  
13 what the issue is planning to do with the funds that its  
14 obtained, about what's going on with the company, about its own  
15 holdings of those funds. That is important information. To  
16 the SEC the harm here is that these individuals could be making  
17 entry into these transactions without having that information.

18 I think the Second Circuit has characterized this as  
19 the essential of the act to protect investors by requiring  
20 registration that again is the Giligan Will case. And there is  
21 a number of sort of what I'll describe as -- statements to that  
22 effect in the Supreme Court's jurisprudence in this area. The  
23 Joinder case from the very beginning talked about the evils  
24 that Congress was trying to address when it passed these laws.  
25 It was the caveat emptor regime that existed for the securities

1 laws that were passed. That's the fundamental harm that the  
2 Securities Act was enacted to address.

3 To the extent that there's any question -- and I don't  
4 think there is -- but to the extent that there's any question  
5 about private versus the public harm that I have just  
6 described, I think the Second Circuit in Management Dynamics  
7 and in the Culpepper case have been very clear that the public  
8 interest is paramount, I don't think it's even a close call.  
9 We respectfully submit that the harm here is solely to the  
10 public if the Court will permit this to continue.

11 In another case that has at least relevant principles  
12 from the Second Circuit called SEC v. Kern, the Second Circuit  
13 reminded the courts that it should not construe Section Five to  
14 incentivize violations by permitting sort of a public offering  
15 to the stopped, by permitting the violation to sort of stop  
16 midstream simply because they're making these statements.  
17 Nothing has really changed in the economic realities at issue  
18 here.

19 So, if I have sufficiently addressed the Court's  
20 question about the standard, I'd like to at least in closing  
21 and reserve some rebuttal if permitted. But in closing, we'd  
22 ask the Court to start exactly where the Court began this  
23 morning which is by looking at the economic reality and really  
24 applying common sense to this transaction. As I mentioned at  
25 the beginning, this was a company that wanted to raise funds

1 and didn't want to do it in the traditional way, didn't want to  
2 have to sell a piece of its company, didn't want to have to  
3 register with the SEC, but it does want and it's asking the  
4 Court to give it an opportunity to take \$1.7 billion indirectly  
5 from members of the investing public without complying with the  
6 registration requirements.

7 In this way, Telegram is seeking to pass on its  
8 problem, essentially, to the investing public that wants the  
9 benefit of that without the responsibilities of disclosure  
10 imposed by the act. Telegram's attempt to do this by this  
11 two-step process versus what it calls a two-step process but  
12 what is really one transaction were selling to venture  
13 capitalists, that Telegram has no use for those things other  
14 than to profit does not put its fund rate outside of the rubric  
15 of securities laws and that shows why registration is  
16 important.

17 When the Court looks at the question that the Court  
18 asked us at the beginning, what is the economic justification  
19 for the -- purchase agreement? There isn't any other than to  
20 create demand and to sort of incentivize some people to decide  
21 I want to be in this trench and some other people to decide I  
22 want to be in the trench that I can sell first. That's what  
23 people do in IPOs. When the Court asks whether the transaction  
24 in the initial purchases provide for consumptive use, the  
25 evidence in the record at the time of the transaction is

1 essentially undisputed that it was not for consumptive use. To  
2 the extent that Telegram can point to anything, it would not  
3 permit a reasonable juror to conclude anything other than these  
4 transactions, that these were not consumers of goods.

5           Lastly, the Court asked what the business  
6 justification is for time of capital for a year or more if this  
7 was just a currency, I have not been able to come up with one.  
8 And in our conversation and in the evidence we've submitted  
9 from these sophisticated venture capitalist, there isn't any.  
10 There is no reason why somebody would do that. There's no  
11 reason why other than in hopes based on Telegram's promises  
12 that Telegrams efforts would be successful that the team that  
13 they touted that would ten years of experience or 15 member  
14 team, that that team could create another successful enterprise  
15 from which they would -- a profit. For those reasons, this is  
16 transaction falls squarely under the Howey test.

17           The Court is quite correct in the statement it made at  
18 the beginning. This case is not about all Cryptocurrencies.  
19 It's not about another transaction. It's not about future  
20 transactions. It's about the transaction that Telegram already  
21 entered into and in the middle of which Telegram finds itself.

22           The Securities Act has a clear mandate and it clearly  
23 empowers the Court as recognized by the Second Circuit to  
24 enjoin an ongoing violation and we simply ask that the Court do  
25 so today and that pursuant to its October 21 order that it

1 extend the current standstill and issue a preliminary  
2 injunction

3 THE COURT: Thank you. We'll take a ten-minute recess  
4 and then we'll resume with Mr. Drylewski's argument.

5 MR. DRYLEWSKI: Thank you, your Honor.

6 THE COURT: Thank you.

7 (Recess)

8 THE COURT: Please be seated.

9 Whenever you're ready.

10 MR. DRYLEWSKI: Thank you, your Honor.

11 If it please the Court, we've put together a small  
12 side deck that we may refer to through the argument. With the  
13 Court's permission I'd offer some up to you, to the Court's law  
14 clerk and to the court reporter.

15 THE COURT: All right. That's fine.

16 (Pause)

17 MR. DRYLEWSKI: Good morning, your Honor.

18 May it please the Court, I'm Alex Drylewski, for the  
19 defendants. It's a little difficult to know where to start but  
20 I'll begin with a statement that your Honor made at the outset  
21 and that is that a digital asset standing alone is inherently  
22 not a security. We agree, and I believe the SEC agrees too,  
23 what would make a digital asset a security is if it is coupled  
24 with a promise from the promoter to undertake essential  
25 managerial efforts leading to a profit for the purchaser.

1           Now, what that means is there has to be a coupled  
2 promise with that asset. The asset could be sold in one  
3 circumstance where it is not a security and it can be sold in  
4 another circumstance where it is a security, depending upon  
5 what the promoter promised in each of those different  
6 circumstances.

7           And to take an example from Howey itself, there were  
8 two essentially two agreements that were offered to the  
9 purchasers, a land sale agreement for orange groves and a  
10 separate service agreement by which the promotor agreed that it  
11 would cultivate the orange groves. It would grow the oranges.  
12 It would sell the oranges and then it would remit the profit to  
13 the purchaser.

14           Now under those circumstances, the Supreme Court held  
15 that an investment contract had been offered because those two  
16 offers coupled together created an expectation in the  
17 purchasers that they would profit solely from the manager's  
18 work and service in generating a profit, the managerial  
19 service.

20           THE COURT: And they weave together two separate  
21 potentially standalone agreements to come to that conclusion.

22           MR. DRYLEWSKI: Precisely, your Honor.

23           And no one would doubt that if it were just the land  
24 contract alone and someone were just selling the orange groves  
25 alone, that would not be a security. It must be the weaving

1 together, as you said, of the promise and the asset.

2 Now, taking that to this case, there is an fundamental  
3 question at issue that we believe the SEC has conflated here.  
4 And that is there was an initial offer that was made to private  
5 purchasers whereby Telegram agreed it would take the funds that  
6 those private purchasers pooled together and it would take  
7 effort to build this ton block chain. And if successful, it  
8 would create the grams and it would distribute those grams to  
9 the purchasers as a return on their investment.

10 Significantly, your Honor -- and this is undisputed --  
11 defendants treated that transaction as a securities offering.  
12 And the reason it did so is because indisputably, the private  
13 purchasers pooled their money together in exchange for  
14 Telegram's agreement embodied in the purchase agreements that  
15 it would undertake those efforts to build a block chain. But  
16 the idea and the intent was that once the block chain is built  
17 and launched, it is completely open source code. It is out  
18 there on the Internet. Telegram will then proceed into the  
19 background and be just one of many in the decentralized  
20 community of network users that would have the ability but no  
21 obligation to continue to undertake any efforts, whatsoever.

22 THE COURT: Well, the image of the decentralized  
23 community after launch, your image of it and the SEC's image of  
24 it actually are not necessarily incompatible. What is the  
25 difference is the timeline. You maintain that that exists on

1 the instant of launch, whatever the moment of launch is, it  
2 exists then. They maintain it will not exist then but may very  
3 well exist at some point in the future. That's where you  
4 differ.

5 MR. DRYLEWSKI: That is exactly right, your Honor.  
6 And in fact, that is one of our points is that it is undisputed  
7 that the end goal here is a decentralized community. The  
8 question is, when will you get there? But that is a time  
9 limited question and courts and case law says that even a  
10 central managerial efforts are managerial efforts that are  
11 temporary on transitory may not rise to the level of a Howey  
12 promise making an investment contract.

13 And we see it come up in cases involving franchisors  
14 and franchisees where a franchisor may give start-up help,  
15 advise, marketing, advertising, but the end goal and the  
16 intention all along is that the franchisee will eventually  
17 takeover and there will be no reliance on essential managerial  
18 efforts of others.

19 THE COURT: What's your case on that? What's your  
20 franchise case?

21 MR. DRYLEWSKI: We have a couple of cases, your Honor,  
22 on this point. One, the franchisor or franchisee case is  
23 called Martin v. Tempest. Let me just pull it up.

24 THE COURT: Sure. We can find the cite, I'm sure.

25 MR. DRYLEWSKI: I have it here. The case is called

1 Martin v. Temp. It's a Fifth Circuit case and the citation is  
2 628 F.2d 887 Fifth Circuit 1980. We also cite for this  
3 proposition in our briefs a case called Alunni v. Development  
4 Resources. It's an Eleventh Circuit case from 2011. And that  
5 case involved the promotion of condos in Florida that were  
6 marketing as a real estate investment opportunity but some of  
7 them came with a one-year existing lease where the promotor  
8 would continue to manage those properties and remit the  
9 profits. And because that was a time-limited issue, because it  
10 was temporary and transitory, those management promises on the  
11 existing leases did not rise to the level of a Howey promise.

12 And if I could refer your Honor to the first slide in  
13 the deck, this is the concept that we're talking about here  
14 about the difference between the private placement which,  
15 again, was treated expressly as a securities offering and post  
16 launch grams which are uncoupled from that promise that's in  
17 the purchase agreement that Telegram is going to undertake any  
18 essential managerial efforts of others.

19 So, the only point here is analytically we have to  
20 look at this at two separate points in time. You look at it on  
21 the day one of the private purchase and you say, was this a  
22 security and we say it is. And we agree that it was. But you  
23 also have to look at grams when they will be offered to a new  
24 set of public gram purchasers in the market.

25 THE COURT: Well, again, the definition of 'terms'

1 sounds picky but it turns out as I think both sides agree to be  
2 quite critical here. And I think what the SEC is claiming is  
3 not merely that you look at whether it's a security on the day  
4 the offer and acceptance is made when it's offered and  
5 certainly, when it's accepted and certainly, when the promise  
6 to exchange consideration is made, but I think they're saying  
7 that it's an offering of securities and then you have to  
8 complete the sentence essentially to whom. And their position  
9 seems to be that with the two tranches or rounds of purchase  
10 agreements at that moment in time there was an offering of  
11 securities that extended to the post launch secondary market.

12 You, as I understand it, I think what you're saying  
13 is, yes, there was an offering of securities but the offering  
14 of securities was to the initial purchaser's, full stop.

15 MR. DRYLEWSKI: That's exactly right, your Honor.

16 THE COURT: It's what this case is here.

17 MR. DRYLEWSKI: One way to try to illustrate this is  
18 take something that I think the parties will agree is not a  
19 security, the purchase of a house. I could buy a house on day  
20 one and on day three I may sell that house but sell it with a  
21 coupled promise to that purchaser that I'll retain possession  
22 of the house. I'll rent it out and I'll remit the rental  
23 proceeds to that purchaser. Now, it's the same underlying  
24 asset but in scenario one it is not a security. In scenario  
25 two it may be a security and I submit that the SEC would not

1 disagree that the second scenario could be.

2 THE COURT: Right. And uninitiated into the law in  
3 this area and neither side is uninitiated here, so I'm perhaps  
4 stating an obvious proposition to both sides. One might be  
5 tempted as a lawyer to say, well, let me look at the agreements  
6 their four corners and that will answer the question. And  
7 there really is not a dispute in this case that that's not how  
8 the economic realities test works. If I could look at the four  
9 corners of the agreements and decided on that and nothing else,  
10 you know kind of as the way we think of the Parole Evidence  
11 Rule and construction of an unambiguous contract, this case  
12 should be very easy and I'd give you five minutes a side to  
13 make your points. But that's not what we're dealing with. So,  
14 I have to look beyond those agreements at the full economic  
15 reality.

16 MR. DRYLEWSKI: Understood, your Honor.

17 And let's look at the economic realities of this  
18 situation. From the beginning of this transaction from day one  
19 Telegram announced that its intention here was to create a new  
20 mass market consumer cryptocurrency. The point was to make  
21 something that could be freely traded, bought, sold and used by  
22 consumers. And you can see that going all the way back to the  
23 offering materials that went to these private purchasers. In  
24 the problem statement for the primer that was given to those  
25 purchasers at ab initio, it said the problem that Telegram

1 identified here is that the technological limitations of  
2 existing cryptocurrencies like Bitcoin and Ethereum have  
3 prevented their widespread adoption among consumers. They say  
4 that because of those limitations most of the purchasers of  
5 those cryptocurrencies are investors and not everyday  
6 consumers. This was the problem that Telegram purported to  
7 identify that it was hoping to solve with this new technology.

8 So, they got their development team together -- it's a  
9 world renown development team -- and created a platform that is  
10 meant to be and has intended from the beginning to be faster,  
11 more scalable and more consumer friendly than any existing  
12 digital platform out there.

13 THE COURT: But let's be candid. Like anybody who  
14 makes a product, I'm sure your product is the best. I'll  
15 assume that for the sake of argument. But essential to the  
16 vision -- doesn't make it a bad vision. It doesn't even answer  
17 the questions in this case, necessarily. But essential to that  
18 vision was the existence of the 200 million -- sometimes I read  
19 300 million -- user base of Telegram messenger and this is  
20 what's going to put this cryptocurrency in everyone's hands is  
21 that we're not starting from zero and creating a name and a  
22 word that no one's ever heard of. We're your friendly folks at  
23 Telegram Messenger who are going to move you gently into a  
24 world of cryptocurrency and there are three hundred million  
25 people who will be open to this idea. Well, I'll try it. I'll

1 try it for a month. I'll try it on the small scale basis, see  
2 how it goes. What could go wrong? And so, it's not the  
3 entirety of the story to say oh, no, no, I have better  
4 scalability. I have better functionality. I am more user  
5 friendly. Everybody claims that about their product. And I'm  
6 sure your clients have come up with something more wiz bang  
7 than the last guy who did it. I'll take that as a given but  
8 there's much more to what that vision was.

9 MR. DRYLEWSKI: So a couple of points there, your  
10 Honor. First of all, no doubt Telegram in its offering  
11 materials said to these private purchasers, we've got an  
12 existing eco system of users out there that a lot of them tend  
13 to be crypto enthusiasts. We have a built-in audience of  
14 people that will be very receptive to this idea and the  
15 potential of adopting them quickly. That was an existing  
16 thing. That was already there. And that was promised to the  
17 private purchasers as part of the value proposition for that  
18 private transaction that, again, was treated as a securities  
19 offering. We do not doubt that the private investors there  
20 sought to profit here.

21 Now, there's evidence that some of them sought to  
22 profit in different ways, including by potentially using their  
23 grams and working as validators which is in and of itself a  
24 money making opportunity, but --

25 THE COURT: Yes. Where is the evidence that any of

1 the initial purchasers were looking to become validators?

2 MR. DRYLEWSKI: So, one of the e-mails, there was an  
3 internal e-mail that the SEC attached recently to one of its  
4 letters post closing of briefing is an internal discussion by  
5 one of the private purchasers where they talk about,  
6 specifically, the idea of staking and making money through  
7 their gram holdings. And that is you can find it at docket  
8 number 108-2. It is Exhibit B to a letter that SEC put in on  
9 February 10.

10 But putting that to the side, your Honor, even if we  
11 stipulated that every single one of those private purchasers  
12 was looking to get financial gain by selling their grams at the  
13 end of the private placement, our answer is "so what?" The  
14 point is that grams when you look at them at that point are  
15 commodities and not securities because have you to look at the  
16 totality of the circumstances at that time. If the Howey  
17 purchasers, who put their money into the growing of oranges,  
18 got oranges back as their return on investments and they want  
19 to go use those oranges or sell them for profit, that is  
20 irrelevant that the subjective intents there. The point is are  
21 the oranges securities at that point in time when you look at  
22 the offers and sales to others?

23 And another example is from the Second Circuit, Glen  
24 Arden. That's a case where the plaintiffs bought whiskey  
25 warehouse receipts. And the plaintiffs in that case said --

1 excuse me -- the defendants in that case said, that's just a  
2 sale of commodities. That's not an investment contract under  
3 Howey. The Second Circuit undertook an analysis that we think  
4 is critical showing the difference between the sale of a  
5 commodity and the sale of an investment contract. And what the  
6 Second Circuit said is, sure, whiskey on its own may be a  
7 commodity but what was bought here was additional services from  
8 the promotor that was absolutely necessary to the promised  
9 profit.

10 But in that scenario if the plaintiff had taken its  
11 whiskey receipts and let's say offered them to a liquor  
12 wholesaler or offered them to someone else, just the whiskey  
13 receipts themselves, without any of those concomitant promises  
14 by the promoter to do any of that other stuff, that would be a  
15 consumer transaction or a transaction in commodities. It would  
16 not be a transaction selling securities subject to the federal  
17 securities laws. And that's what we're saying is going to be  
18 the future transactions of grams postlaunch. That was the  
19 vision and the intention of Telegram all along. This project  
20 would not work if the idea was grams are securities on day one  
21 and they're always securities or they're securities at the time  
22 of launch when we launch the ton block chain and we're done  
23 with any managerial efforts.

24 So, when your Honor posed the question, what happens  
25 if Telegram goes to the Bahamas and you can't find them

1 again --

2 THE COURT: No. I said the British Virgin Islands.  
3 They are incorporated in the British Virgin Islands. That's  
4 what I said.

5 MR. DRYLEWSKI: Thank you for the correction, your  
6 Honor.

7 If they go anywhere and disappear and no one can count  
8 on them to lift a finger again, the question has to be asked.  
9 It's not one question. It's two. The first is, if they did it  
10 at the beginning of the private placement, the answer is the  
11 private purchasers would not have made a penny because they  
12 were relying on Telegram to create that block chain platform.  
13 That was the essential managerial efforts promise that was made  
14 and that's why that was an investment contract.

15 But if Telegram upon the launch decides to go to the  
16 British Virgin Islands, Bahamas or Buffalo, New York and never  
17 seen again, that does not change what gram purchasers in the  
18 market will expect. Because what Telegram has said from the  
19 beginning and has reiterated and reemphasized to anyone who  
20 will listen is that the entire nature of this decentralized  
21 block chain platform, and the only reason why it will work is  
22 if there is not one person managing this. The Telegram recedes  
23 into the background and because it's an open source code,  
24 anyone can come in and can build these applications and smart  
25 contracts on it.

1           And in fact, we have seen based on public reports that  
2 there is already strong interest from third parties to build  
3 these types of use cases and applications on the platform. And  
4 we submit that is remarkable here, judge, given that there's a  
5 cloud of uncertainty based on this very litigation. There is  
6 still strong evidence that the decentralized community out  
7 there of independent third parties is looking at this block  
8 chain as a chance for them to make money entrepreneurly by  
9 building smart contracts and block chains, applications on  
10 block chain that gram purchasers in the market can use or not  
11 use. But there won't be these essential managerial efforts by  
12 Telegram that are in the words of Glen Arden in the Second  
13 Circuit, absolutely, necessary to the promised profits.  
14 Telegram is not promised any profits to gram purchasers in the  
15 future in the market coming in after the block chain has been  
16 built. And even if it did, those profits would not be based on  
17 any of Telegram's efforts.

18           Now, the idea that Telegram may want to continue to  
19 drive more consumption and more demand for this product  
20 postlaunch, that's the same as any manufacturer of a consumer  
21 product wanting to create a widely used product. That, in and  
22 of itself, cannot create an expectation of profits of the kind  
23 that Howey contemplates.

24           And to give an analogy, if I were to buy season  
25 tickets to the Mets, I may think, rightly or wrongly, that I

1 might profit from those tickets by reselling them in the future  
2 at a higher value. I may also generally expect again, rightly  
3 or wrongly, that the Mets will undertake efforts to improve  
4 their roster to improve their stadium and to market themselves  
5 to a new fan base or expand their following.

6 THE COURT: That sounds like a fantasy.

7 MR. DRYLEWSKI: My other team is the Buffalo Bills.  
8 So, I picked that as the more plausible analogy.

9 THE COURT: I guess you've been schooled by Mr --

10 MR. DRYLEWSKI: We've has some interesting  
11 conversations about Gil Hodges but that's a separate topic.

12 But the point is, I may have those expectations that  
13 the team will undertake those efforts. And those efforts may  
14 all have a very positive effect on the value of my season  
15 tickets but that doesn't make my season tickets a security.  
16 And the reason why is because the crucial element there is that  
17 the Mets have to promise to me, we're selling you those tickets  
18 as an opportunity to profit based on our essential efforts.  
19 That is the critical piece of any Howey investment contract.  
20 And that looking at grams postlaunch, we submit, is the  
21 critical piece that's missing here. And so if a gram purchaser  
22 you're looking at it from their perspective coming in  
23 postlaunch, what are they looking at at this point? They're  
24 looking at the fact that Telegram has built the block chain.  
25 The platform is up and running. It is open source code and

1 anybody can build on top of it. In fact, as Telegram has told  
2 everyone, anyone can copy the block chain code and launch their  
3 own block chain with their own idea and own name for it.

4 So, gram purchasers looking at that situation will  
5 come in and they will buy grams for one of three reasons.  
6 They'll either do it because they want to use them as a medium  
7 of exchange, just like Bitcoin. People use it as a store of  
8 value and to transfer value to others on the block chain.  
9 Either that, either to use it in connection with smart  
10 contracts and applications that may be built on top of the  
11 platform, that's what Ethereum does. People use the name of  
12 Ethereum tokens in order to run smart contracts which give  
13 values to those users.

14 Or three, they do it for speculative reasons because  
15 they want to profit by buying it low and they think they can  
16 sell it high. None of those are enough to satisfy Howey.  
17 Commodities are bought and sold for speculative reason and for  
18 gain all the time. People trade currencies. People trade gold  
19 and silver and sugar and futures relating to all those as well.  
20 That doesn't make it a security because what those people were  
21 doing is they're relying on force of supply and demand and  
22 they're hoping that what they're buying the demand will go up  
23 over time or that someone will buy it from them at a higher  
24 price. But that is not reliance on the essential managerial  
25 efforts of Telegram and it can't be, your Honor, we submit,

1 under the facts here that both sides agree.

2 And just going back again to the economic realities  
3 here, if you turn if you could to slide 20. The SEC in its  
4 reply brief put in a summary of its notion of what the economic  
5 reality of the value for grams is and I'd like to read it.

6 "The economic reality as investors themselves  
7 succinctly explained it, is that the value grams represent  
8 could potentially grow based on the efficacy and success of  
9 Telegrams or other third parties' efforts to create some demand  
10 and value for them in the future so they may be resold at a  
11 higher price. That makes grams securities."

12 Your Honor, we submit that does not make gram  
13 securities. The SEC doesn't cite a case for that proposition.  
14 We submit there is none. What that highlights is that grams in  
15 the market following launch at the ton block chain will not  
16 carry any of those absolutely necessary essential managerial  
17 efforts of others.

18 Now, your Honor, turning just quickly to the words  
19 that Telegram used when it describes this, both to the private  
20 purchasers and to the public gram consumers in the future, we  
21 take your Honor's point that disclaimers are not dispositive.  
22 You have to look past the words that are used. But there are  
23 long lines of cases after Howey that say that the words mean  
24 something. They cannot be disregarded.

25 Going all the way back to joiner where the Supreme

1 Court said that offerings "must be judged as being what they  
2 were represented to be". And here what Telegram said from the  
3 beginning -- and it's on slide 14, your Honor. Telegram said:

4 "Grams are intended to act as a medium of exchange  
5 between users in the ton ecosystem. Grams are not investment  
6 products. There should be no expectation of future profit or  
7 gain from the purchase or sale of grams."

8 Your Honor, that was made to every private purchaser  
9 in the private offering. They repped and warranted to reading  
10 and understanding it. Those are sophisticated investors. And  
11 then it was re-emphasized and reiterated in a public notice to  
12 every member of the public, including any potential gram  
13 purchaser in the market if this project is allowed to launch.

14 We submit that we are not aware of a single case where  
15 a promotor made that clear a statement, that definitive a  
16 statement to potential purchasers and the Court, nevertheless,  
17 imposed an investment contract. And we would direct the Court  
18 to the SEC v. Life Partners case. It's D.C. Circuit. There  
19 the purchasers bought certain viatical contracts and they  
20 claimed they were investment contracts because they said the  
21 defendants promised that they would make a secondary market for  
22 those instruments and they would profit on them.

23 The D.C. Circuit rejected that theory and emphasized  
24 that in the written materials the defendants warned plaintiffs  
25 specifically that those viatical contracts are not liquid

1 investments and there can be no guaranty that there would be  
2 any secondary market that's developed for those contracts. The  
3 D.C. Circuit emphasized that fact.

4 We would also point your Honor to Davis v. Riao  
5 Rancho. It's a case Judge Brieant decided of this court.  
6 There the plaintiffs bought land in New Mexico and they claimed  
7 they were led to expect profits based on the sole efforts of  
8 the developer promotor. Judge Brieant dismissed that case. He  
9 said even if the defendants in fact built roads or improvements  
10 on the property at issue, that is not the type of managerial  
11 efforts contemplated under Howey and Forman because the  
12 defendants did not make promises that they would run the  
13 development and distribute profits to the plaintiffs. There  
14 was no management agreement between the parties, nor were the  
15 defendants obligated under the purchase agreement to undertake  
16 any of those efforts. Cases are legion on this point, your  
17 Honor. The Rodriguez case from the First Circuit. The De Los  
18 Ranchos case from the Ninth Circuit. They all say that there  
19 the plaintiffs believed they were led or anticipated or  
20 expected that the defendant promoters were going to build up  
21 these thriving residential communities and they were going to  
22 appreciate, the investments of those plaintiffs were going to  
23 appreciate in value based on those efforts. And in each one of  
24 those cases the Court said, no, generalized, even strong and  
25 repeated suggestions that something may happen is not enough.

1 When you look at the contracts here, the contract was a  
2 conveyance of land and fee simple and there was no obligation  
3 to undertake any specific essential managerial effort.

4 We submit that those cases are on all fours here. And  
5 just because a purchaser may anticipate or expect that  
6 postlaunch, Telegram may continue to be involved. Even putting  
7 aside whether that's an essential managerial effort that is not  
8 enough under Howey.

9 THE COURT: But I look at it from the perspective of  
10 what the offeror is intending to communicate.

11 Is that correct?

12 MR. DRYLEWSKI: That's exactly right.

13 THE COURT: Is it what the or what the offeror expects  
14 that a reasonable purchaser would understand? Perhaps, that's  
15 better said.

16 MR. DRYLEWSKI: We don't see that formulation in the  
17 case law, your Honor. But, objectively speaking, what the  
18 cases say is you have to look at what was said. The words of  
19 the promoter are paramount. And what does that convey  
20 objectively speaking? You don't look subjectively at what are  
21 the anticipations, the inferences or the expectations.

22 THE COURT: Right. You don't look, you cannot look  
23 solely at what's in the mind of the purchaser.

24 MR. DRYLEWSKI: Not only that. You can't, your Honor,  
25 because otherwise something could be a security to you and not

1 a security to me.

2 THE COURT: I get the point. I get that point.

3 MR. DRYLEWSKI: On that point just one other point,  
4 your Honor, and we think this is a significant admission if you  
5 turn to slide 18 of the deck. This is from the SEC's  
6 opposition brief at page nine. The SEC says:

7 "The Court should not engage in speculation about what  
8 a reasonable purchaser might expect in the future based on  
9 Telegram's shifting statements about its intention. The  
10 evidence in the record is insufficient to ground any such  
11 speculation.

12 Your Honor, we submit that is a remarkable concession  
13 because if the best that the SEC can do here or ask the Court  
14 to do here is speculate as to what a reasonable purchaser might  
15 expect postlaunch, then we submit it has not met its burden for  
16 a preliminary injunction and it has not met its burden to raise  
17 a material issue of fact to oppose our motion for summary  
18 judgment.

19 Your Honor, I don't want to beat a dead horse but I  
20 did want to point out if you turn to slide six here, we're not  
21 asking you to take our word for it on this difference between  
22 an investment contract where there is a digital asset that is  
23 coupled with a promise of essential managerial efforts of  
24 others putting that in contradistinction to just the underlying  
25 token itself. SEC Commissioner Hester Peirce, just this month

1 said, put out a speech and a new proposed safe harbor for  
2 digital asset developers where she made this point that the SEC  
3 has been criticized for enlightening the distinction between the  
4 investment contract through which a digital token may be  
5 offered or sold and the digital token itself. And she says the  
6 contract transaction or scheme by which the token is sold may  
7 constitute an investment contract. But the object of the  
8 investment contract, the token, may not bear the hallmarks of a  
9 security. And conflating those two concepts has had disastrous  
10 consequences on the ability for token networks to build up.

11 We submit that that is what the SEC is doing here.  
12 They are conflating the two things. The token itself, the  
13 grams upon launch of the ton block chain will not be wrapped in  
14 an investment contract. They will not carry with them any  
15 ongoing promises, commitments or agreements by Telegram to do  
16 anything. In fact, Telegram has expressly disavowed that and  
17 in fact, Telegram is technologically precluded from doing  
18 anything from a government standpoint. It has represented to  
19 the world it will not act as a validator. The validator's on  
20 the system, without getting too technical in terms of  
21 technology, the validators are a dispersed community of network  
22 users. And what they do is they reach consensus through the  
23 software to validate the transactions and the contracts that  
24 exist on the platform. That, both of the parties expects agree  
25 that's the backbone and the heart of the platform going forward

1 once its been built.

2 (Continued on next page)

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1           MR. DRYLEWSKI: (Continuing) And those validators will  
2 not include Telegram. They will be a dispersed community of  
3 other network users that will govern and run this platform. So  
4 to the extent --

5           THE COURT: Although you can't say that that won't be  
6 the case for some portion of the life post-March, that Telegram  
7 may step in if a community of validators does not emerge  
8 immediately but with the distinct desire to exit at the  
9 earliest opportunity when there are enough validator nodes up  
10 and running.

11          MR. DRYLEWSKI: So --

12          THE COURT: Is that right?

13          MR. DRYLEWSKI: Essentially, your Honor. But just one  
14 note there. It does bear noting that Telegram has said from  
15 the beginning that if there is some flaw in the blockchain, it  
16 is very likely and possible that that may never get fixed  
17 because what Telegram can do in its role following the launch  
18 of the blockchain is it can recommend proposals for fixing the  
19 code. But those proposals to be implemented have to be  
20 implemented by the validators.

21          THE COURT: I understand.

22          MR. DRYLEWSKI: But putting that aside, assume that  
23 Telegram will say: Oh, oh no, we just launched a faulty  
24 product and will want to stand behind it and try and find ways  
25 to fix it. We submit that is no different than a manufacturer

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1 putting a product out into the market with a warranty. It is  
2 temporary, transitory and incidental to the essential  
3 managerial efforts of building the blockchain to begin with.  
4 That commitment is embodied in the purchase agreements that  
5 expire by their terms at the launch.

6 THE COURT: So if there were a flaw in the blockchain  
7 technology, Telegram would anticipate doing what it could to  
8 put out a fix. Once it's launched doesn't guarantee that  
9 everybody is going to buy into the fix, but that they would put  
10 a fix out.

11 MR. DRYLEWSKI: They would put out a proposal almost  
12 undoubtedly, your Honor. But we don't know. What their  
13 intentions would be to actually go forward with it depends,  
14 obviously, on the circumstances and what the nature of the  
15 problem and the fix is.

16 But assuming for the sake of these motions that  
17 Telegram is incentivized to and would put out a proposed fix,  
18 the validators then can say: Yeah, that seems like a good fix,  
19 we'll implement it. And if two-thirds of them vote it through,  
20 it gets implemented in the system.

21 Or they could say: Telegram, you put out a faulty  
22 product, we don't think you know what you're talking about, and  
23 may look to other solutions to fix it in order to go forward.

24 THE COURT: I understand. But on my other point, if  
25 there is not a community of validators that emerges on day one,

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1 Telegram stands ready to step into that role for some period of  
2 time postlaunch.

3 MR. DRYLEWSKI: I can't represent that that is the  
4 case, your Honor.

5 What Telegram has said is that it does not have any  
6 superior rights and it has represented and made clear it will  
7 not validate; it will not govern the system.

8 So it could be --

9 THE COURT: You're not disclaiming however -- whatever  
10 those words mean, you're not disclaiming that if in the  
11 immediate postlaunch period there is not an emergent community  
12 of validators, you're not the disclaiming that Telegram would  
13 step in and fill that role for some period of time?

14 MR. DRYLEWSKI: So it cannot. So just to draw a  
15 distinction. I think this is part of the --

16 THE COURT: Why can it not?

17 MR. DRYLEWSKI: Because, one, it is just -- it cannot  
18 be -- it has said it will not be a validator.

19 THE COURT: Let's pause. Let's pause. Words matter  
20 here.

21 MR. DRYLEWSKI: Sure.

22 THE COURT: And I know you're not your client. You  
23 take what you know from your client. But there is a world of  
24 difference between cannot and will not. So explain what you  
25 mean.

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1 Is there a "cannot" or is it a "will not"?

2 MR. DRYLEWSKI: Thank you, your Honor.

3 I will do my best as probably a poor interlocutor of  
4 the technological issues here. But as I understand it, the  
5 validation process is called a consensus mechanism.

6 THE COURT: Yes.

7 MR. DRYLEWSKI: And what it requires is that a certain  
8 number of nodes, independent nodes all validate a transaction.  
9 If two-thirds of them agree, then that is a valid transaction  
10 for purposes of the platform. One party standing alone cannot  
11 create consensus by itself. So what you would be left with is  
12 let's assume Telegram would step in and, I don't know, would  
13 say these are good transactions, you can trust these  
14 transactions. What our expert would say that is not a  
15 successful blockchain. It sort of loses its very essence as a  
16 decentralized ledger because you now have a centralized  
17 governing force.

18 THE COURT: I got it. And I understand that. And in  
19 that sense I get your point about "cannot."

20 But, if a community of validators does not emerge in  
21 the immediate postlaunch period, is Telegram disclaiming that  
22 it will endeavor to foster and incentivize the creation of that  
23 validator community?

24 MR. DRYLEWSKI: I do not understand Telegram to be  
25 disclaiming those efforts.

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1 THE COURT: That's fine. You've answered my question.

2 MR. DRYLEWSKI: Thank you.

3 THE COURT: My question was imperfectly phrased and  
4 thank you for the assistance.

5 MR. DRYLEWSKI: Not at all, your Honor.

6 But it is -- apropos of this conversation, it is worth  
7 noting that the SEC's expert has recognized that on the test  
8 net there have been 36 validator nodes that were set up. That  
9 is strong indication that there is that interest on day one for  
10 folks to act as validators.

11 And just, again, not to get too much into the  
12 technology, but it's not like Telegram has this product behind  
13 a curtain and is, on day one of the launch, going to whip it  
14 out and say here it is, here's the technology we've been  
15 developing.

16 There's been a test net where the code for this  
17 blockchain platform has been publicly available. It began  
18 rolling it out in March of last year. And so the entire  
19 public, anyone in the world, can go on, can look at this code,  
20 can test it out, can try simple smart contracts, see how they  
21 interact with the code base, and can set up validator nodes.  
22 And we know 36 parties have set up those nodes to act at  
23 validators. So there is interest in that.

24 THE COURT: But, there is a real commitment when one  
25 actually -- this is not something one does in your gym shorts

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1 at night in their spare time. This is, as I understand it,  
2 becoming a validator is a business in and of itself for which  
3 there are incentive shares available that Telegram can release  
4 to validators, no?

5 MR. DRYLEWSKI: You are right. The Court is right in  
6 the sense it is a business in and of itself and that it is a  
7 moneymaking business and one that people will be highly  
8 incentivized to do.

9 A clarification on the way it works mechanically.  
10 Telegram does not reward the validators for their validation  
11 work. And this is part of the concept of decentralized  
12 platforms that takes -- that takes some people by surprise.

13 It's all built into that protocol. So it's  
14 automatically executed. If the validators reach consensus on a  
15 block and it is appended to the end of this distributed ledger,  
16 they're rewarded from the system with newly minted Grams. It's  
17 like Bitcoin mining where people can do the validation work  
18 necessary and they get the Bitcoin not from Mr. Bitcoin or some  
19 foundation. They get it from the technology itself. And so  
20 it's self-regulating, self-working, decentralized and Telegram  
21 will not play that role going forward.

22 Now, there's been some talk about the TON Foundation.  
23 If your Honor would like, I'm happy to address that.

24 THE COURT: Yes, please.

25 MR. DRYLEWSKI: First and foremost, Telegram, when it

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1 was looking at the details for this project back in 2017, it  
2 made the specific decision to build a lot of flexibility into  
3 the details of this product for the very reason of making sure  
4 that it complied with not just the U.S. federal securities laws  
5 but all applicable laws and regulations in this very new and  
6 emerging space.

7 And so what it thought at the time is it looked at  
8 other successful blockchains in terms of being allowed to  
9 operate, like Bitcoin and Ethereum. And those platforms had  
10 their own foundations. They're typically not-for-profit type  
11 companies that have involvement with the blockchain platform.  
12 They may publish nonbinding research reports. Some of them may  
13 give out small incentives to developers to generate activity on  
14 the blockchain. The Ethereum Foundation does that everyday, is  
15 doing it right now.

16 So that was the thought behind it. Telegram  
17 determined that we could establish a TON Foundation that would  
18 have similar goals, similar roles and responsibilities. But it  
19 told every single one of the private purchasers in the purchase  
20 agreements and in the risk factors that went with all of the  
21 offering documents that we may never establish this TON  
22 Foundation. We intend to. We think it's a good idea. But we  
23 may never do it. And in the public notice that Telegram put  
24 out in January, it said the same thing, that the TON Foundation  
25 will not be established at launch and it may never be

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1 established.

2 THE COURT: So who owns or who has a beneficial  
3 interest in the 52 percent of Grams that have not been the  
4 subject of the offer, the purchase agreements?

5 Now I know that there's a certain, I think it's two or  
6 four percent for developers. I'm not talking about that. I'm  
7 talking about the reserve.

8 MR. DRYLEWSKI: Sure.

9 THE COURT: Who owns the reserve?

10 MR. DRYLEWSKI: So for the record -- when the Grams  
11 are created at launch, assuming the launch were to incur,  
12 58 percent of the Grams would go to those private purchasers  
13 that bought them through the purchase agreements.

14 THE COURT: All right.

15 MR. DRYLEWSKI: That subscribed to them.

16 Then 28 percent of those Grams would go into a wallet  
17 designated for the TON Foundation. And the idea is that they  
18 would be held in a smart contract, unable to be used for  
19 voting, validating, transferring, buying, selling unless and  
20 until the TON Foundation is established in the future.

21 If the TON Foundation is never established, then those  
22 Grams will stay in that wallet. They will be locked up in  
23 perpetuity. If the TON Foundation is establishment, Telegram  
24 has represented and committed that it would be done with the  
25 following parameters. It would be a not-for-profit

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1 organization. It would be governed by a board of directors  
2 that is a majority independent board, meaning three of the five  
3 members at least would have no affiliation with Telegram or any  
4 of its employees. And that the foundation can do only one of  
5 three things. And this will be all set out in a publicly  
6 available charter and governance documents. They can publish  
7 nonbinding research and opinions about, hey, here is what we're  
8 seeing is going on in the TON blockchain, isn't this great or  
9 isn't this not great. Here's what we think about it. They can  
10 give out small incentives in Grams to developers and people to  
11 promote the consumptive use of Grams. And I think the example  
12 we give in our brief is someone spends ten Grams on some  
13 product or service, the Foundation may have a deal where they  
14 give one gram to that person, to try and get this currency  
15 being used by consumers. And third, they can sell Grams into  
16 the market but only if the free market price for Grams were to  
17 rise above this hypothetical reference price.

18 THE COURT: I'm familiar with that.

19 So if the market price rises above this hypothetical  
20 reference point, theoretical reference point, and now hard  
21 currency is generated, who owns the hard currency?

22 MR. DRYLEWSKI: The TON Foundation does.

23 THE COURT: So now you said 58 percent will go to  
24 those who have entered into the purchase agreements?

25 MR. DRYLEWSKI: Correct, your Honor.

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1 THE COURT: Is that what you're saying?

2 28 percent is in the wallet and may be locked up in  
3 perpetuity in the wallet for no one to ever have. And what  
4 about the balance?

5 MR. DRYLEWSKI: So then there is the four percent that  
6 your Honor mentioned that is the currency -- the cryptocurrency  
7 that Telegram will pay to its employees and founders. And the  
8 last ten percent is Grams that Telegram has reserved to use --  
9 to give out itself as incentive payments to consumers in the  
10 market or to developers.

11 THE COURT: OK. So Telegram has raised 1.7 billion  
12 dollars and it does not and has not committed to use that  
13 1.7 billion exclusively for development of the TON blockchain,  
14 correct?

15 MR. DRYLEWSKI: That's correct, your Honor.

16 THE COURT: So as I understand it, net of what they do  
17 happen to spend on such activities, including promotional  
18 activities and paying your well earned legal fees it can be  
19 dividend-ed up to the owners of the business?

20 MR. DRYLEWSKI: Yes. The funds that were raised in  
21 the private placement were disclosed to everyone that they  
22 could be used without -- essentially without limitation.

23 THE COURT: So I mean when I say "used" they, net of  
24 whatever Telegram elects to spend, really and truly is  
25 available to go into the pocket of the shareholder owners.

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1 MR. DRYLEWSKI: I think that's right. Yes.

2 THE COURT: OK. Thank you.

3 MR. DRYLEWSKI: Your Honor, unless you have any other  
4 questions on Grams and the *Howey* analysis, there were a few  
5 issues that the SEC raised regarding the bona fides of the  
6 exemptions and the private placement, I'm happy to address  
7 those if your Honor would like.

8 THE COURT: It's really up to you at this point. And  
9 then I would propose to hear a brief rebuttal from the movant  
10 on the preliminary injunction.

11 MR. DRYLEWSKI: Thank you, your Honor. Just very,  
12 very briefly then.

13 THE COURT: Sure.

14 MR. DRYLEWSKI: The SEC's theory of why the private  
15 placement exemption was blown is hinged on this notion that it  
16 was, in fact, a disguised public distribution. We submit that  
17 is really asking the same question that we've already talked  
18 about, because if Grams are not securities at the point that  
19 they're created and can be available to be distributed to the  
20 public, then by definition there cannot be a public  
21 distribution of a security. So the question again funnels back  
22 to that second question, not whether Grams are securities at  
23 the time of the private placement but whether Grams are  
24 securities at the time that the blockchain is launched and for  
25 the first time the public will be able to buy those Grams.

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1           Now the SEC made some points that there were some  
2 finder's fees agreements. We struggle and have struggled from  
3 the beginning to understand how that makes anyone an  
4 underwriter here. What Telegram did is it entered into certain  
5 placement agent agreements with certain foreign entities to  
6 find investors to backfill where certain of the private  
7 investors in the second round didn't come through with their  
8 contractual obligations to pay.

9           But what those agreements said, first they excluded  
10 the U.S. They were all exclusively ex-U.S. They were only in  
11 jurisdictions that the parties agreed to. And those finders or  
12 placement agents were not permitted under the agreement to  
13 negotiate, solicit, or do anything with respect to potential  
14 investors. They were only permitted to funnel them to Telegram  
15 or Telegram would then negotiate and make the offers.

16           We see nothing wrong with that here, your Honor, in  
17 the context of a private placement. It certainly doesn't  
18 create an underwriter. And they were not reselling Grams,  
19 these finders. In fact, some of them were not even investors  
20 in the private placement.

21           But what the record does reflect is that not only did  
22 Telegram put in very strong representations and warranties that  
23 each of these private purchasers had to agree to, that they  
24 would not transfer any interests in Grams prior to the launch,  
25 at which point, again, we submit that Grams will not be

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1 securities, so that shouldn't be an issue from that point going  
2 forward, but not only did they make those reps, but they are  
3 required to repeat those reps again at the time of the launch  
4 as a precondition to receiving their Grams, that they haven't  
5 transferred any interests.

6 Now, we think that the --

7 THE COURT: Who has to repeat their representations?

8 MR. DRYLEWSKI: The private purchasers, your Honor.

9 THE COURT: Both tranches?

10 MR. DRYLEWSKI: Correct.

11 THE COURT: Go ahead.

12 MR. DRYLEWSKI: And although we don't think it's  
13 relevant to the reasonable care analysis here, the record  
14 shows --

15 THE COURT: What happens if they're fibbing when they  
16 say we haven't made any agreements to sell in a secondary  
17 market prelaunch and we haven't done any of that, what happens  
18 if they're fibbing? If they're caught, they're caught. If  
19 they're not caught, I guess they get away with it?

20 MR. DRYLEWSKI: If they're caught, your Honor, because  
21 Telegram had specific information showing that they actually  
22 engaged in reselling, Telegram will and has, and the record  
23 reflects this, excluded purchasers from the private placement  
24 altogether and canceled purchase agreements. Telegram has done  
25 that.

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1           But where there is no specific evidence that Telegram  
2 can point to to say we know you're fibbing, Telegram sort of  
3 has its hands tied and would be opening itself up to a lawsuit  
4 if it just canceled a purchase contract from an investment  
5 without the ability to prove it.

6           But one of the reasons why Telegram selected these  
7 highly reputable, highly sophisticated purchasers in the first  
8 instance is so that it could take comfort in the fact that  
9 these highly sophisticated investors were making these  
10 representations and would stand by them --

11           THE COURT: Well, let me ask you. Is there right now,  
12 as we speak, an ongoing secondary market in Grams?

13           MR. DRYLEWSKI: There are rumors that there is some  
14 secondary trading of Grams, whether it's Grams or interest in  
15 Grams or derivative trading, it's --

16           THE COURT: It wouldn't be in Grams. It would be an  
17 interest in Grams. Right.

18           MR. DRYLEWSKI: It would be akin to like say pre-IPO  
19 trading. There are rumors of that. But where Telegram has  
20 specific evidence that a specific purchaser is violating the  
21 terms and the reps in their purchase agreement, it follows up  
22 there. And if there is evidence, it cancels the purchase  
23 agreements. That's what it's agreed to do. Otherwise, if  
24 there was more that was required, it would basically make  
25 Telegram the guarantor of all of these private purchasers that

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1 they weren't going out and doing their reselling or otherwise  
2 it would blow the exemption. We submit that's not the law.

3 The law is focused on what are the defendant's  
4 efforts. And we submit it's at the time of the transaction  
5 when it's entered into. 502(d) says it's reasonable care that  
6 the purchaser is acquiring the security for him or herself. At  
7 that time -- the SEC doesn't point to a single red flag that  
8 any of these private purchasers had side deals to resell their  
9 tokens or had designs to go out and find someone exchange for  
10 these Grams. The only thing that they can argue at that point  
11 is that, what everybody understood, Grams would be resold at  
12 the launch at a time when everyone expected and intended that  
13 Grams would not be securities. They'd be the oranges in  
14 *Howey*. They'd be the return on the investment.

15 And the last point is the SEC called that launch the  
16 liquidity event. The liquidity event. That's right. What it  
17 was was the private purchasers with were getting back currency  
18 as a return on their investment. Now whether they go and they  
19 exchange that for another currency, sure. But the liquidity  
20 event is that point in time. That's the transaction. And  
21 looking past that liquidity event and that transaction, the new  
22 transactions in the market with new Gram purchasers coming in,  
23 that needs to be assessed at that point in time and that's  
24 where we submit, again, running the *Howey* analysis there, Grams  
25 do not fit within the definition of investment contract because

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1 there is no promise of essential managerial efforts.

2 THE COURT: Thank you.

3 MR. DRYLEWSKI: I suppose the last point I would just  
4 make, your Honor, and then I promise I'll sit down, is if your  
5 Honor is considering the preliminary injunction request, I know  
6 that under the terms of the parties' agreement that expires  
7 technically today unless it is extended by consent or a request  
8 by one of the parties. We obviously don't believe that the SEC  
9 has met its burden of a clear showing of either a past  
10 violation or of the likelihood of a future violation given  
11 everything we've said. But we also submit that from the  
12 beginning Telegram, these defendants have maintained  
13 flexibility with respect to the details of the project and if  
14 there's one particular aspect of this project that concerns the  
15 Court they are willing and able to have that enjoined, not do  
16 that, if it means that the project itself can launch which we  
17 believe it should be allowed to do under *Howey*.

18 THE COURT: Well, let me ask you this. There are two  
19 possibilities. One is that you consent to the continuation of  
20 the existing injunction pending determination of the  
21 preliminary injunction motion. The other is that you don't  
22 consent, at which at the conclusion of today's session I will  
23 rule.

24 Do you consent?

25 Do you want a moment to consult with your colleagues?

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1 MR. DRYLEWSKI: If I could, your Honor, please.

2 THE COURT: Sure.

3 (Counsel confer)

4 MR. DRYLEWSKI: Thank you, your Honor.

5 The one point I just wanted to make on the record, the  
6 concern here about the timing, is that under the purchase  
7 agreements themselves, if the blockchain doesn't launch, then  
8 the investors are entitled to their money back less the amount  
9 spent. And that date right now is April 30. Now, that's some  
10 ways off but that is the only concern is that --

11 THE COURT: I'm mindful of that.

12 MR. DRYLEWSKI: Thank you.

13 THE COURT: I don't anticipate that that will be a  
14 problem in terms of a ruling.

15 MR. DRYLEWSKI: Thank you, your Honor.

16 We consent to that.

17 THE COURT: Thank you.

18 MR. DRYLEWSKI: Unless your Honor has any further  
19 questions.

20 THE COURT: Thank you.

21 MR. DRYLEWSKI: Thank you.

22 THE COURT: All right. And I'll hear briefly from the  
23 movant.

24 Everybody is a movant here today; movant, crossmovant,  
25 cross-crossmovant.

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1 MR. TENREIRO: And amici.

2 THE COURT: And amici. We have plenty of amici here  
3 too.

4 MR. TENREIRO: Thank you, your Honor.

5 Your Honor, what I heard from Mr. Drylewski was more  
6 labels: Sugar, apartments, gold. And what I did not hear was  
7 an answer to one of the -- not even one of the Court's three  
8 questions at the beginning.

9 What was the economic purpose behind the lockups?  
10 What was the economic purpose behind locking in money for a  
11 year, \$1.7 billion in order to buy other currencies? And I  
12 didn't hear an answer to the question about whether the reality  
13 of this transaction at the beginning was for use other than a  
14 concession by Mr. Drylewski that, in fact, it was not, that it  
15 was for investment.

16 I could end there but I would like to address a couple  
17 of the other points that Mister -- that the defendants made  
18 with respect to some of the cases that they cited.

19 They cite the Glen-Arden case, your Honor, which we  
20 think is a case that is extremely helpful for the SEC where the  
21 Second Circuit rejects the notion that you can just come up  
22 here and say this is a contract for the delivery of futures.  
23 That's exactly what the defendants said and the SEC prevailed  
24 in that case. Simply saying that it's the contract for the  
25 future delivery of whiskey was not enough. The Court said you

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1 have to look at the economic reality.

2 To the extent that the defendants rely on franchise  
3 cases outside of this circuit, I will direct the Court to the  
4 Aqua-Sonic case, which I mentioned in my opening and which,  
5 again, looks at economic reality very cleverly and very --  
6 looking at a lot of factors. And I think that's one of the  
7 problems that essentially is at the core of the defendant's  
8 arguments, is that they try to separate the economic reality  
9 that *Howey* instructs us to look at. They'll look at Mets  
10 tickets and they look at gold and they look at certain aspects  
11 of other things that surely share characteristics with  
12 investment contracts. And in doing that, they're sort of  
13 obfuscating the clear picture that emerges when the Court takes  
14 a step back as the Court did at the beginning of today's  
15 hearing and looks at the entirety of the economic reality in  
16 the transaction.

17 Telegram insists on framing the question as to what's  
18 going to happen between future purchasers and has not provided  
19 the Court with any legal reason why that should be the case.  
20 As I mentioned a moment ago, it refuses to answer the question  
21 of what the transaction was at the beginning. And worse than  
22 that, I think what Telegram is doing is they're recasting the  
23 promise that they made from: We're going to make the best  
24 blockchain ever, millions times over to: We're going to launch  
25 something. That's how Telegram is seeking to recast the

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1 promise that it made in 2018 in order to say, to plausibly  
2 claim that they're about to walk away.

3 But even then Mr. Drylewski discussed a lot of efforts  
4 that Telegram is reserving the right to make and is not  
5 disclaiming any of those efforts.

6 Excuse me, your Honor, if I may get the slides from my  
7 table.

8 THE COURT: Sure.

9 MR. TENREIRO: I think the Court, once again, sort of  
10 hit the nail on the head when it recognized that it's simply  
11 implausible to think that this company that prides itself on  
12 its reputation is going to walk away from this project and  
13 leave it in shreds if there is nobody there to pick up what the  
14 company wants to do.

15 The defendants talked about validators and the Court  
16 engaged in a colloquy about that. The other thing that  
17 Telegram promised it would do is that it would use the  
18 Foundation to select and to use its expertise to select  
19 which -- who are the parties that it might give these Grams to,  
20 to incentivize them to develop other apps for the system.

21 It is perfectly reasonable for a purchaser of these  
22 instruments to think that Telegram and its smart,  
23 world-renowned team hopefully will pick the best ones, sort of  
24 like the defendant in Gary Plastic was picking the best banks  
25 to get the securities from and creating a market for them.

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1 That's what reasonable efforts are.

2 Mr. Drylewski would not on this stand, in front of all  
3 the press that's here, Telegram will not disclaim that its  
4 reputation is on the line here. Mr. Durov, in his deposition,  
5 was very clear that he prides himself a lot in the reputation  
6 of this company. It's implausible to think that they're going  
7 to walkaway and just deliver a dud of a product after they've  
8 staked their entire business on it.

9 Now, in terms of disclaimers, I think slide 14 shows  
10 exactly why the courts don't look at disclaimers, look at them  
11 with suspicion. The first -- the disclaimer that the  
12 defendants pointed us to is a disclaimer that's contained in  
13 risk disclosures. And it says Grams are not investment  
14 products. There should be no expectation of future profit or  
15 gain from the purchase or sale of Grams.

16 But the defendants concede that that's exactly what  
17 the initial purchasers bought the Grams and entered into these  
18 agreements for. So for them to point -- this is why the courts  
19 are smarter than that. The courts don't focus on these the  
20 disclaimers. They focus, as the Court is, on economic reality.

21 On the distribution point, your Honor, what would  
22 Telegram should have done. Telegram said there's rumors.  
23 There's rumors about -- of secondary market. I will submit to  
24 the court that alone disproves that they're entitled to a  
25 Regulation D exemption.

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1 Telegram has the obligation, and under the Chinese  
2 Benevolent Association case, the Second Circuit has instructed  
3 the courts to look at the entirety of the process, not just at  
4 the moment of the sale. That's also in the R.A -- I think it's  
5 called R.A Hallman test, another case from the Second Circuit.

6 THE COURT: But you don't decide something based on  
7 rumors. Rumors are rumors.

8 MR. TENREIRO: No, no, that time true.

9 What I mean to say is the fact that Telegram doesn't  
10 know if there's a secondary market shows that it's not taking  
11 it's Regulation D obligations seriously. Telegram has the  
12 ability at the very least to ask --

13 THE COURT: Well, listen if participating in a  
14 secondary market is a violation of your purchase agreement and  
15 may jeopardize your ability to receive Grams, I would think  
16 that a wise but deceptive purchaser would take steps to conceal  
17 that secondary market because it's at a minimum a breach of  
18 contract.

19 MR. TENREIRO: And despite that the SEC was able to  
20 find out who was behind the liquid sale and Telegram seems to  
21 not have been able to do that. And the SEC has brought forth  
22 to this Court --

23 THE COURT: Well you have slightly better subpoena  
24 power than they do.

25 MR. TENREIRO: But they have the ability to cancel

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1 this contract. And we only found out -- I don't want to get  
2 into the process by which we found out about this, which we can  
3 get into if the case should proceed. But the point I think is  
4 that Telegram -- I mean the record is undisputed that Telegram  
5 received e-mails about this sale and did nothing about it.

6 Now I think -- we submit that's certainly enough to  
7 meet our burden for a preliminary injunction and enough for  
8 there to be no facts from which a reasonable jury could  
9 conclude that Telegram met its exemption.

10 To close, your Honor, I'd like to go back to where we  
11 began which is *Howey*. One of the many favorite lines in *Howey*  
12 that I look to is where the Supreme Court explained in that  
13 case the land tract agreement embodied the interest that the  
14 investor had. The land sale agreements were incidental, the  
15 Supreme Court said, because the land sale agreements  
16 permitted the promoter to remember or to figure out what  
17 percentage of the interest everybody had so *Howey* would  
18 distribute the profits.

19 In this case Grams are that. Grams embody the  
20 interest of the initial purchasers in this enterprise.  
21 Technology perhaps has permitted Telegram to give them the  
22 Grams rather than distributing the profits by sending them  
23 dollars. But that is the economic reality that the investors  
24 entered into in 2018. And nothing that Telegram has said today  
25 changes that economic reality simply because it hasn't given

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1 the actual keys to the purchasers to those Grams.

2           When the Court takes a step back and understands that  
3 economic reality, there is no conclusion other than the Grams  
4 were part of the investment contract that was sold and these  
5 sales of these investment contracts are entitled to no  
6 exemption. Therefore, we are entitled to a preliminary  
7 injunction.

8           THE COURT: Thank you.

9           MR. TENREIRO: Thank you.

10           THE COURT: On the consent of the parties, the  
11 injunctive relief in the stipulation and consent order entered  
12 by the Court on October 21, 2019 is extended until the  
13 determination of the motion for preliminary injunction and  
14 other interim relief. So it is ordered that defendants shall  
15 not offer, sell, deliver, or distribute Grams to any person or  
16 entity until the determination of the motion for a preliminary  
17 injunction and other interim relief. And that, of course, is  
18 on consent.

19           I want to thank the attorneys and those behind the  
20 scenes who have worked with them to put together really a first  
21 rate set of papers. And one thing I'm going to point out is I  
22 was particularly pleased at the joint stipulation which makes  
23 my life and my understanding of things a lot easier. You're  
24 officers of the court. You're advocates for a party. Neither  
25 side's clients were prejudiced by agreeing on certain basic

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1 facts. It just tees it up so the judge can do the judge's work  
2 better. So I hope you remember the lesson of that as you go  
3 forward in other cases, that this is really valuable because  
4 what you want is a decision that is reasoned and informed  
5 unless you really have such a loser of a position that you  
6 don't want that, you want to cloud the mind of the judge so  
7 that it will go off in some orbit and you have a nice shot at  
8 the Circuit. But I don't believe that was the case here. So  
9 my compliment is most sincere and the quality of the oral  
10 advocacy today is among the best I've had in this courtroom,  
11 including, of course, Mr. Musoff, who is right up there and was  
12 so patiently quiet today.

13 So the decision is reserved. I thank you all very  
14 much. We are adjourned.

15 (Adjourned)

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