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Rebecca G. DiStefano



William Hubbard

Market Trends: Blockchain Initial Coin Offerings (ICOs) - Risks, Regulations, and Riches

by Rebecca G. DiStefano, Greenberg Traurig, P.A.; and Bill Hubbard, Hubbard Business Counsel

Overview

This article addresses distributed ledger/Blockchain capital funding, including the legal framework for capital formation using distributed ledger/Blockchain technology to enable offerings of coins, tokens, and other rights for which no definitive legal guidance yet exists. Blockchain technology is a chain of blocks of discrete bit-lengths containing information embedded in computer code which, when connected to other blocks, constitutes a trusted distributed ledger technology application. Blockchain technology can be molded into technological, financial, social, business, and legal applications through computer code with embedded smart contracts, smart assets, and other features supporting verification, creation, and/or recording of transactions involving private or public parties. This note highlights the need for sound plans and guidance well before finalizing and launching any Blockchain-related offering, as well as prior to making any modest-or-greater investment into any distributed ledger related offerings.

In 1778, two years into the U.S. Revolutionary War, an 800 link, 35-ton iron chain was forged, assembled into at least 53 blocks of 9 links (plus connector) each, and strategically strung across the Hudson River at West Point. That chain's use was essential to both blocking of the British forces and shipments and the creation of a country which later birthed 150 years of rapid world economic growth. Yet world economic growth is now mired at a bleak 2% rate for our, our children's, and their children's lives if noted economist and author Thomas Piketty's 2013 forecast bears its distasteful fruit. Against this sobering backdrop, crowdfunding in its various iterations, unwinding regulations, and tax and securities law changes have offered some modest, better hopes. But human inventiveness, if both unleashed and focused, often creates unseen futures. One such future includes a new type of chain, distributed in blocks of cryptographically verified computer code known as Blockchain, as well as other distributed ledger technologies, which together are spawning various emergent behaviors and economic and social effects.

Blockchain token and other offerings first appeared around 2013 with the staged Initial Coin Offering (ICO) by Mastercoin—an early Blockchain protocol. 2017 has seen an explosion of Blockchain related offerings with many thousands or more likely in the works. Blockchain offers potentially staggering economic and social transformation and wealth creation through, among other results, eliminating the need for many trusted third parties and generating emergent behaviors from self-executing smart contracts embedded within the blocks or other distributed ledger technologies (such as the Tangle network which eliminates the need for so-called miners who cryptographically verify individual transactions). For simplicity, Blockchain is used herein to mean all distributed ledger technology, and although the capital funding phenomenon is world-wide, this article addresses only the existing U.S. legal framework.

Blockchain: Digital Age Trading and Finance

Blockchain technology has been called a revolution, with countless potentials. One of these is to fundamentally reconstruct and decentralize the financial services industry by privatizing and securing confidential data while lowering uncertainties in trade and economic transactions through a consolidated and permanent registry. Blockchain has entered the global lexicon, though the technology is still in its infant stages, little understood, and not widely used by firms and individuals at this juncture to transact business.

So, then, what are the legal and business risks of Blockchain transactions? Why is Blockchain technology breeding a seemingly endless wave of ICOs currently predicted to raise \$3 billion for formative businesses by year-end 2017 by seemingly self-regulated means? Have ICOs modernized and liberated capital formation?

What is a Blockchain?

Blockchain technology in its most distilled form is a type of distributed digital ledger technology or recording of transactions and the foundation for transfers of value. Blockchain has become a headline for its use as a digital ledger in which transactions made in bitcoin or other cryptocurrencies (i.e., mediums of exchange that are digital, alternative, or virtual currencies) are recorded chronologically and publicly. According to the U.S. Securities and Exchange Commission (SEC), Blockchain is another term for an electronic distributed ledger that is disseminated to participants in a virtual organization allowing parties (in theory, and to varying degrees in practice) to transact business securely and privately without third party intermediaries. Blockchain technology, with its use of cryptographically hash-linked blocks in one organizational model, may enable participants in decentralized autonomous organizations (DAOs) to govern and operate without formalized incorporation or organization, functioning through pre-programmed code running on numerous nodes or computers connected and operating in, for such purposes, ad hoc networks. A DAO is online and considered autonomous because the code of the DAO may only be altered if 51% or higher percentage of the members of the DAO agree to the coding change. The DAO is considered decentralized because participants can acquire tokens to participate in these systems and then later sell or exchange their tokens without the need for any trusted third party (such as a bank or other clearing or verifying authority).

A cryptocurrency token using Blockchain (such as bitcoin and ether) may be acquired by a process called mining. Mining is the process of adding a verified transaction block to the distributed ledger. This results in the miner receiving the applicable formula-established amount of tokens (such as bitcoin or ether) in return for providing the verified proof of work. Cryptocurrency tokens may also be purchased directly from the issuer in an initial or subsequent coin offering or, after issuance, directly from their owner or through any cryptocurrency exchange which has agreed to act in such capacity (and which, in today's regulatory regime, may or may not have appropriate licensure to do so).

Limitless Applications for Blockchain

Applications for Blockchain technology are envisioned and developing across an array of industries, both financial and non-financial, although Blockchain technology is most closely associated with crypto-asset mining and trading. Illustrative applications for foundational Blockchain technology in progress include trading or investing in virtual currencies (such as bitcoin and ether), smart contracts (contracts executable in computer coding between and limiting interaction to the contracting parties), safekeeping and digital wallets for smart assets (allowing one to hold and secure ether, Ethereum's tokens, and other virtual assets), cloud storage, digital identity (allowing one to submit personal information electronically for verification), digital voting (enabling a secured and verified system of casting election votes through electronic devices), decentralized notary services, and a myriad of other applications to enhance the privacy and security of online information.

Killer App of Blockchain: Bitcoin and Ether (and other virtual currencies)

Blockchain technology has been driven by the burgeoning market for cryptocurrencies. Bitcoin economic transaction, in particular, has been called the first "killer app" of Blockchain technology and has been the catalyst for distributed ledger innovation and design. Cryptocurrencies exist in many forms, with the earliest cryptocurrencies being virtual currencies operating like coin and paper legal tender, such as bitcoin (and later ether and Ripple). Virtual currencies are not, to date, issued by any country's government (though 2018 may likely see various governments doing so). They are created and memorialized in digital ledger systems and are used by some vendors and consumers for trading goods and services. Although reluctant to recognize the validity of this emergent market, banking and financial authorities and institutions are now publicly acknowledging that virtual currencies are far more than a fad with two-thirds of the world's central banks studying distributed ledger technologies.

Bitcoin

The phenomenal growth of the most well-known cryptocurrency, bitcoin, has raised awareness of uses of Blockchain technology and fueled its growth. By most accounts, the first bitcoin transaction occurred in January 2009 on the heels of the 2008 financial crisis in part due to distrust of traditional financial authorities and anti-establishment sentiments. Bitcoin was initially designed to act as a secure peer to peer decentralized payment system. Despite having no government recognition as fiat capital (except in Japan) and a limitation on supply, bitcoin has surged with a market capitalization of in excess of \$100 billion (i.e., valued as 1 bitcoin equals as high as \$11,400 in U.S. dollars) in late November 2017. The banking industry, although slow to onboard and integrate cryptocurrencies into operations, now seems to be yielding to market demands. On October 2, 2017, Goldman Sachs announced that it would explore bitcoin trading operations in response to client interest, and on October 31, 2017 the CME Group announced that it will launch bitcoin

futures trading before the end of 2017 subject to receipt of all regulatory approvals. Numerous issuers have been formed to offer bitcoin associated debit cards allowing consumers, businesses, and other vendors to both spend and accept the currency. Bitcoin is considered a scarce asset due to the finite number of bitcoins that may be created (a maximum of approximately 21 million) under its coding structure (with about 80% mined to date and with all anticipated to be mined by 2140). The speculation is that miners, by being the first to cryptographically hash a block and thereby “minting” a code-fixed number of automatically issued new bitcoins, will no longer be needed after 2140, although verifications will continue through transaction fees to be charged for each transaction.

Ethereum

The Ethereum platform market is younger than bitcoin and developed preternaturally after its 2015 live launch. The Ethereum cryptocurrency is called ether and was initiated following an initial offering of 60 million units of ether raising \$18.5 million. Ethereum’s web site describes ether as

“a necessary element -- a fuel -- for operating the distributed application platform Ethereum. It is a form of payment made by the clients of the platform to the machines executing the requested operations. To put it another way, ether is the incentive ensuring that developers write quality applications (wasteful code costs more), and that the network remains healthy (people are compensated for their contributed resources).” See <https://www.ethereum.org/ether>.

This market is considered to have more utility and flexibility of use than bitcoin, allowing the execution of smart contracts and serving as a problem-solving development platform for a range of industries. The Ethereum platform describes itself as focused on the creation of decentralized markets, “store registries of debts and promises,” and moving funds in accordance with past instructions, all without an intermediary or counterparty risk. Ether is currently capped at 18 million ether released per year, although the rate of issuance is expected to change over time.

Crowdfunding 2017: Fueled by Blockchain

Distributed ledger and Blockchain technology capital formation is a disruptive force in 2017 that was not envisioned five years ago. When enacted, the Jumpstart Our Business Startups Act of 2012 (112 P.L. 106, 126 Stat. 306) (JOBS Act) signaled to the finance community the end of one era and start of another. Its elimination of many advertising and solicitation restrictions ushered in a brave new world of investment crowdfunding sanctioned by a U.S. Congress intent on modernizing capital formation and communications under the Securities Act of 1933, as amended (Securities Act). Unrestricted advertising and open communications with the public became generally permitted as long as the communications were truthful and investors were verified to be accredited. Yet for unaccredited investors (and accredited investors who wished to invest more than \$100,000 per year) Regulation CF (17 C.F.R. §§ 227.100 - 503) and the SEC’s related regulations have, to some critics, failed to provide a catalytic practical framework for small-business capital formation and growth due to high compliance costs and lack of easily navigable paths to successful use.

Paralleling the deliberately plodding JOBS Act SEC rule adoption process, a community of creative code-writers, code-developers, and financiers adopted and implemented Blockchain technology in the form of new cryptocurrencies and their platforms developed, or not, through the use of eyebrow-raising amounts of coveted start-up capital. During 2013 and 2014 (and for some through today) many of these coin and token offerings bypassed, to the thinking of their implementers, state and federal securities laws on the basis that they were offering commodities—virtual currencies which, dependent upon each unique offering, could be exchanged for value—and not any sort of investment contract or security. And yet, as they should by today have belatedly recognized, such creations operate in a spectrum of regulatory colors with a focal point seemingly now squarely-centered on value creation through the managerial efforts of others. See ICO Structures below.

It is important to examine where, in the regulatory landscape, crowdfunding and Blockchain related offerings currently are. Crowdfunding finance during 2017 continues to encompass both regulated (through the JOBS Act including Regulation D Rule 506(c) (17 C.F.R. § 230.506), Regulation A (17 C.F.R. §§ 230.251 – 263), and Regulation CF offerings) and non-securities law offerings.

Blockchain Funding: What are ICOs and Token Offerings?

Blockchain technology offerings, known as Initial Coin Offerings and Initial Token Offerings (generally referred to in financial technology or FinTech parlance as ICOs), quietly emerged as offspring of the social media donation and charitable crowdfunding popularized by Kickstarter and, for investment contracts, the resulting crowdfunding legislation and SEC rulemaking legally formalized under the JOBS Act.

ICOs have not been funded from the crowd in the sense that they have not used Regulation CF regulated portals or traditional crowdfunding platforms and, while the extent of the nature and number of ICO purchasers is unknown, it is generally believed that the audience has been comparatively narrow. Most ICO issuances have been made directly by the issuers and in some cases, ICO purchases or subscriptions require payment in bitcoin or ether. Many, particularly since the SEC’s July pronouncement (discussed

below), are now believed to have required verification of accredited investor status. Upcoming and pending ICOs are advertised on digital platforms generating significant publicity. Although the original legislative intent of investment crowdfunding was to democratize both access to capital for small-business and availability of investment opportunities in small-business for both accredited and non-accredited investors, ICOs are somewhat of an exclusive club for technology investors with specialized training or education, as well as access to information, about building systems, platforms, and applications for relevant markets. Moreover, ICOs have quickly become the center of attention for speculators with no awareness of, or with a conscious disregard for, securities or other legal requirements (propelled in part by success stories of digitally disruptive companies in taxi services and consumer retail which were based and grew on such a philosophy). Yet while ICOs may today appear to mostly be investment crowdfunding, the catalyst for the growth in ICOs remains a desire by their founders to both build new, better worlds by solving and providing solutions to real-world demands and, by doing so, amass personal financial security and, perhaps, a fortune.

ICOs, in summary, are offerings of new digital coins or tokens sponsored by digitally-based organizations and their creators. Many of these founders have been willing to issue these tokens (whether by or to identified or anonymous persons) without regard to whether their sale or a buyer's purchase has complied with securities and other financial regulatory frameworks. In some cases, ICOs raising millions may not have been offered by legal entities as that term is commonly understood, but rather may exist as a DAO through the efforts of one or more founders and a tech-savvy founding team. After initial creation, these DAOs may have no managerial controls apart from the pre-programmed distributed ledger embedded coding necessary to carry out the stated functions of the network (including the applied mathematical formulae, with resulting emergent effects, embedded in the Blockchain or other code).

ICO Structures

There is no current template or market standard for an ICO. Until recently, the world of ICOs seemed, to its participants, largely self-regulated. On July 25, 2017, the SEC released its DAO investigative report warning issuers of cryptocurrencies that offerings may be subject to U.S. federal and state securities laws (The DAO Report), which is available at <https://www.sec.gov/litigation/investreport/34-81207.pdf>. The DAO Report cautioned market participants that the sale of tokens must be analyzed under the test created in *SEC v W.J. Howey Co.* (328 U.S. 293 (1946)) defining an investment contract as involving the investment of money, in a common enterprise, with an expectation of profits from the efforts of management or other third party.

Utility Tokens

Certain models of the ICO sell or pre-sell tokens with utility or product-like rights and features. These may include rights to vote or contribute labor, as well as rights to access, mine, and license the Blockchain technology at hand. A growing consensus among many U.S. law firms and securities practitioners is that token sales used solely to purchase products, services, or mining rights in enterprises under development should not (provided they are not directly, indirectly, or implicitly marketed using their potential as investments) be considered securities under U.S. federal laws based on the Howey legal framework. The theory behind this thinking is that the token value is derived from speculations in the token's asset class and consumer uses in the related network, rather than an expectation of future profits from those involved in the management of the enterprise. In the case of utility tokens that are purchased mainly for consumer-like uses (e.g., for bartering, trading, coupons, or in payment for services, products, or network fees), the Howey test profit motive arguably may not exist or may be secondary to the consumptive nature of the transaction.

Some tokens may provide membership rights, loan collateral, or redeemable coupons for goods and services. Utility tokens, in some cases, may act as currencies in a functional network. Those seeking to classify utility tokens as securities will argue that if no network sufficient to constitute an established market capable of being readily valued yet exists, the code embedded in the blocks constitutes the managerial effort of others upon which the utility token is to depend for any value in excess of the exact market value for the service, goods, or consumer uses represented by the token as of the date of purchase (taking into account any future delivery).

It remains to be seen whether the SEC and other regulators take a light or not-so-light regulatory approach to utility token sales. The SEC, since the September 2017 formation of a distributed ledger technology and ICO-focused Cyber Unit, has filed two ICO related enforcement actions through December 26, 2017. Both of these enforcement actions shed light on how the SEC will approach utility token sales, though we focus here on the most recent. On December 11, 2017, having scrutinized an ICO sale of subscriptions for purported utility tokens, the SEC issued a cease-and-desist consent order (the Order) preemptively halting the distribution of tokens to fund a restaurant review app for use with iPhones as an unregistered sale of securities. See *In the Matter of Munchee Inc.*, SEC Release No. 33-10445, available at <https://www.sec.gov/litigation/admin/2017/33-10445.pdf>. The SEC observed that Munchee targeted purchasers of digital assets reasonably expecting profits from a rise in value due to the creation of a Munchee ecosystem resulting from Munchee's efforts and those acting on its behalf. The Order held that the sale was of an unregistered security in violation of the Securities Act. The Order notes that even if the so-called MUN tokens had a practical use at the time of the offering, such focus would not preclude a finding that the sale of subscriptions constituted the sale of an unregistered security. The SEC's analysis turned on the classification of MUN tokens as investment contracts, focusing on, among other factors, Munchee's general solicitations touting the opportunity to profit and promising to develop a secondary trading market within 30 days of the conclusion of the offering. While

many legal commentators have stressed the need for centralized or directed management (as opposed to a distributed autonomous organization) in order to find an investment contract constituting a security, the Order, perhaps strategically, cites the language of *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975) which does not mandate such a conclusion. The Forman decision holds that it is the entrepreneurial or managerial efforts of others which govern whether something is a security. The holding would not seem to dictate a difference in result dependent upon whether an issuer actively managed or aided in the development of an ecosystem or whether profits emerge from the independent entrepreneurial efforts of others (which is a characteristic of emergent systems) participating in distributed autonomous organizations. It would therefore now be prudent for any issuer to assume that if a token purchaser reasonably expects profits to result from the entrepreneurial efforts of others, the token may well be found to be a security. Such a conclusion would likely mandate either registering the sale of tokens under the securities laws or offering the tokens under Regulation D, Rule 506(c) or other applicable exemption.

Contemporaneously with the Order, the SEC chairman Jay Clayton issued a statement on cryptocurrencies and ICOs, which is available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>. The chairman noted that, to date, no ICOs have been SEC registered and no exchange-traded funds containing crypto currencies have been registered, and that offerings of coins or tokens occur outside U.S. borders. He stated he has asked the SEC's Division of Enforcement to police and vigorously enforce violations of the federal securities laws in this arena. Regulators' 2018 pronouncements and actions, as well as those of any private litigants whether individually or through class actions, will have a direct effect on how much and how quickly the technological and financial U.S. sectors associated with Blockchain and cryptocurrency (which are today most heavily concentrated in the United States and to its technological benefit) continue to develop.

Tokenized Securities

If the token, coin, or other digital asset purchased provides an ownership interest in equity, or a future right or conversion right to own a stake in the enterprise or receive returns based upon the traditionally defined managerial work of others, the digital asset will generally be considered a security under the traditional Howey test. Based on the authors' review of Form D reports filed with the SEC and publicly available white papers, some ICO participants are now electing to be regulated under U.S. federal securities laws. Tokenized securities may be sold under Regulation D of the Securities Act, and Rule 506 promulgated thereunder, though tokens have not yet been expressly included in the federal securities law definition of "covered securities" and, thus, are not preempted from state securities registration except to the extent exempted, such as being sold under Regulation D. Currently, issuers in ICOs are required to comply with state securities or blue sky laws in states where the tokenized securities are offered and sold, and secondary (non-issuer) sellers of the tokens must comply with the state blue sky laws in resale transactions to the extent such token constitutes a security.

Simple Agreement for Future Tokens or Equity (SAFTE)

The Simple Agreement for Future Tokens or Equity (SAFTE) has been proposed as a compliant investment contract to facilitate the initial funding of Blockchain-based offerings made to accredited investors. The SAFTE, as currently structured, is a derivative instrument designed to effectuate the future issuance of tokens in order to obtain the financing needed to fund a tech product or system prior to its development or commercial launch, and may represent a promise for future tokens at a fixed price: in effect, a simple promise to issue a certain number of tokens based upon the happening of one or more future events. The SAFTE agreement may be structured so that investors receive these tokens if and when the network launches. The SAFTE (or similar investment structure) could also be used to raise funds for further network or other related development with tokens to issue at a future time based upon the happening of certain events. In each setting, the SAFTE may be a forward contract regulated by the Commodity Futures Trading Commission (CFTC), if no exemption from such regulation exists, and, thus, network developers should seek legal counsel in the careful drafting of these instruments if considered for use. From an investment standpoint, one would need close scrutiny to help determine whether such investment has value, and, if so, what that value is (and its believed present and future bases to make any determination about its place as a small part of an investment portfolio). The SAFTE, analogous in structure to the crowdfunding SAFE (a misnomer for Simple Agreement for Future Equity) should not be characterized as standard, simple, or safe. The SAFTE framework of pre-selling tokens has generated skepticism in the legal community on several grounds including oversimplification of securities laws. This framework, if followed, may result in a heightened risk to investors, token price manipulation, and fraudulent trading practices.

Practical Guidance for Development of Blockchain Technology Ventures

The legal landscape governing Blockchain technology is changing daily. As of September 30, 2017, state legislation granting legal validity to Blockchain-based distribution (and in some cases, smart contracts) has been passed in several states including Vermont, Arizona, Nevada, Maine, and Delaware, with bills and resolutions related to Blockchain pending in Illinois, Hawaii, and New Hampshire, though this legislation has not addressed securities law considerations. Globally, financial regulators are, on a weekly basis, issuing penalties, official permissions, regulations, and other missives related to cryptocurrency transactions.

A global and multi-disciplinary planning approach is rapidly becoming a necessity to organize and launch a Blockchain or other distributed ledger based technology business. Technical know-how and a sound legal basis in intellectual property, financial technology, and securities regulation are fundamental to the successful inauguration, development, and deployment of the venture.

Key Initial Steps to Prepare and Raise Capital and Launch a Blockchain Technology Venture

To ensure the success of a Blockchain technology business, consider the following actions mission critical prior to the commencement of the ICO:

1. Consult with and ensure the availability of a dedicated team of developers with prior experience in Blockchain coding and web development.
2. Prepare a legitimate and comprehensive white paper describing the planned development of the technology business, including a persuasive case for the economic and/or social benefits of (and need for) the to-be-developed network, solution, product, platform, or service.
3. Incorporate or organize the business in a state, such as Delaware, with statutory recognition or pending legislation for Blockchain protocols and smart contracts. For example, the recently revised Delaware General Corporation law makes it possible for entities to place shareholder records such as issuances, sales, and redemptions on a computer-based distributed ledger.
4. Understand the complete regulatory landscape based on advice in the planning stages from your team of legal advisors. Developers of Blockchain-based networks should be aware of potential regulation under the following state and federal laws:
 - a) Intellectual property laws
 - b) Privacy laws
 - c) Securities and commodities laws, including broker-dealer regulation
 - d) FTC and business opportunity laws
 - e) Tax laws
 - f) Banking law
 - g) Money-transmitter business law

Investing in an ICO

The complex business and legal environment surrounding ICO events is changing rapidly and is being outpaced by the constant acceleration of business and technological innovation.

Many cryptocurrency offerings will prophylactically subject themselves to SEC and/or CFTC jurisdiction (as well as the U.S. Department of the Treasury Financial Crimes Enforcement Network (FinCen) for money services businesses) and expressly pronounce that in the ICOs. Seeking to capitalize on the uncertainty, liquidity, relative anonymity, volatility, and scale offered by the cryptocurrency market, fraudulent ventures without a legitimate basis in Blockchain technology or otherwise pump and dump or Ponzi-type ventures have already been the subject of SEC enforcement action. It is expected that such enforcement actions, when such schemes have been found, will continue.

Investors are cautioned to secure a review of a nascent-stage or developmental venture's white paper well in advance of investment and consult with legal and investment advisors experienced in securities law and financial technology initiatives.

Market Outlook

Blockchain technology will begin to transform financial and digital consumer markets globally. Business infrastructures will continue a slow migration toward Blockchain and other distributed ledger based platforms. Many visionary research and development companies formed around or inspired by distributed ledger technology will generate promise, excitement, and, frequently, irrational behaviors. Distributed ledger technical impediments such as scalability, the need for mining, mining processing time, and integration of systems will each be a significant focus for both ICO and non-ICO tech firms.

It remains to be seen whether the light touch taken by the SEC, CFTC, and other U.S. regulators will continue. While it seemed plausible mid-year 2017 that regulators would generally leave offerings made to accredited investors, in the absence of fraud, to

the marketplace for money-losing investors to use private remedial actions for redress, the SEC has refocused attention on its DAO Report, cautioning that the economic realities of a transaction must be acknowledged and the recordation of a corporate interest on a distributed ledger may not in fact change the legal substance of that transaction. The SEC's simultaneous releases on December 11, as noted above, including a statement on cryptocurrencies and ICOs by SEC Chairman Jay Clayton and the proactive Munchee Inc. enforcement action, likely foreshadow an acceleration of enforcement activity in 2018. Chairman Clayton's statement, while retaining tempered optimism for the growth of technologies and a commitment to promote capital formation, contained messages for both main street investors and market professionals. Investors should ask common sense questions and demand clear answers, and market professionals should consider the correct legal classification of assets as currencies (versus securities) or utility tokens (versus tokenized securities). Another catalytic enforcement action or two (claiming all material facts and risks have not been disclosed) may be one tool chosen by the SEC to prompt issuers, even for accredited investors, to expand the economic, risk, and tax analysis portions of the sort of white papers now commonly in use as well as to ensure filings of Form Ds or other mandated filings. For ICO issuers not excluding non-accredited investors in their offerings, serious enforcement actions seem assured. ICO offerings have not altered the U.S. investment regulation landscape, though federal regulators have generally opted to put the industry on notice and to limit enforcement actions so far. These and other regulators will continue to evaluate the nature of and uses for tokens, with attention to offerings structured to emphasize the utility of these tokens, though retaining, substantively, the earmarks of a security. In their balancing of the need for economic growth and capital formation with investor protection, they will not hesitate to take forceful actions to prevent wide-scale abuses. It is highly probable that many of the 1300-plus ICOs to date will fail due to insufficient business uses or inability to obtain critical mass. It appears historically inevitable that a highly-publicized ICO will fail and action to protect non-accredited investors will result in future ICOs looking more like traditional private placements (with additional disclosures and appropriate regulatory filings). Exchanges dealing in cryptocurrencies will increasingly be under the scrutiny of the SEC, CFTC, and other federal and state regulators. Those behind failed ICOs and those which become subject to SEC action should expect to be targets of individual claims for losses despite the accredited nature of most such investors.

The SEC's recent public statements that many ICOs are not sufficiently transparent, and that most tokens offered thus far exhibit most of the "hallmarks of a security," support our strong conclusion that the agency will begin to more aggressively enforce federal securities laws and regulations in this area during 2018, expanding enforcement beyond ICO fraud cases. Consequently, those ventures planning ICOs should begin to increasingly consult with legal counsel at an early stage to structure and craft disclosure documents compliant under existing federal and state securities and other applicable laws, and file notices of sales of securities with the SEC and states.

Based upon its recent statements, the SEC also may, in its future regulatory enforcement actions, distinguish certain first-mover digital currency assets such as bitcoin, ethers, and selected other similar existing virtual currencies (which have reached a critical mass sufficient to constitute a traditional fiat currency, commodity, or money and which lack the commonplace tells of a security) from those other offerings and sales of tokens which have not yet reached a critical mass and may have the commonplace tells of a security. Regulatory agencies' comparatively few enforcement actions against ICOs thus far are probably due to such factors as the technology employed, the use of the terms coin and token, the perceived lack of widespread harm, the focus on accredited investors, the challenges in differentiating a commodity with a security, regulatory resources, and the speed of the roll-outs. With over \$4 billion raised in 2017 ICOs, a total market cap of over \$600 billion (\$250 billion if bitcoin and ether are excluded), and roughly 1300 ventures to date, regulatory eyes are now clearly focused on the ICO and the highly volatile token markets. So, for those considering or contemplating investing in or issuing ICOs or other token offerings, it is a good time to keep abreast of developments and plan and take any actions appropriately.

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