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# The Evolution of Token Offerings and Regulation: From ICO to STO

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DECEMBER 2, 2019

## INTRODUCTION

Token offerings (historically referred to as "initial coin offerings" or "ICOs") are typically viewed as an alternative method of capital raises for early-stage companies through the offer and sale of a digital token or asset in exchange for either fiat money or cryptocurrency. According to CoinSchedule (see https://www.coinschedule.com/stats/ALL?dates=Jan+01%2C+2018+to+Dec+31%2C+2018), over $21.6 billion was raised globally during 2018, almost triple the $7.4 billion raised in 2017. Entrepreneurs and both private and retail investors have become increasingly involved in this new avenue for raising capital, disrupting the traditional funding path from venture capital through initial public offering (IPO). And, as blockchain technology continues to become more mainstream, the capital markets will similarly evolve by broader acceptance of token sales.

Seed and venture financing can be accomplished through derivative-type instruments that provide the purchaser with the issuer's tokens, once the platform is launched. Initial raises in this space utilized a new form of investment contract called a SAFT, or Simple Agreement for Future Token. The SAFT was based on a concept that the to-be-issued tokens did not constitute a security and would be freely tradable upon creation and issuance. This analysis was met with criticism from some sectors within the legal and academic community. Consequently, this elevated the discussion by market participants and regulators over whether token issuances were in fact securities, requiring compliance with applicable securities laws in and outside the United States.

Between 2015 and early 2017, the market for tokens received great interest from a new breed of investors seeking to capitalize on the phenomenal growth of and returns from sales of cryptocurrency. Hundreds of millions of dollars could be raised almost overnight in some cases – a result previously unheard of for start-up ventures. Regulators around the globe were relatively quiet on the topic, and there was a legitimate question as to whether tokens should be treated as securities, commodities, property or something else.

In most jurisdictions, the classification of digital assets determines how ICOs are regulated. Some countries have moved to introduce new regulation in this area (such as South Korea, the EU, the UK, France, Malta and the Cayman Islands), while others have banned token offerings entirely (such as China and, to a limited extent, Russia). In the U.S., both the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC) have asserted authority over token transactions, with enforcement actions on the rise by the SEC, the CFTC and state regulators starting in late 2016 for cases of fraud, viewing many token sales as Ponzi schemes. Meanwhile some jurisdictions outside the U.S., such as Switzerland and Singapore, have created jurisdictional safe havens for token offerings with minimal interference from regulators.

## THE APPLICATION OF U.S. FEDERAL SECURITIES LAWS

The U.S. approach to regulating digital assets has been to work within its current laws, rather than introduce new ones, as well as to highlight the risks to people arising from or related to token offerings and trading. The SEC has stated that it would not change securities laws to cater to digital assets, and will prosecute fraudulent token offerings.

In July 2017, the SEC issued the DAO Report, relying on its investigative authority under Section 21(a) of the Securities Exchange Act of 1934 (the "Exchange Act") rather than its enforcement power. Essentially, the SEC took this opportunity to lay out a simple roadmap for the marketplace on how to sell tokens: comply with existing federal and state law. As a basis for its guidance, the SEC applied the *Howey* test to the facts and circumstances of its investigation to assess whether tokens issued by a blockchain company would fall within or would violate federal securities laws. Under *Howey*, a transaction may constitute a security if (a) there is an investment of money, (b) in a common enterprise, (c) with an expectation of profit, (d) primarily through the managerial or entrepreneurial efforts of others.

The DAO Report highlighted the need for market participants to assess whether the sale of a token was, in fact, a security. To conclude a token is not a security subject to applicable federal and state law, the token must have a pure utility function. The SEC has noted notwithstanding a token's use on a particular platform to access products or services or enable certain functionality, it is important to assess all facts and circumstances relevant to the issuance in determining whether the offer and sale of a token is a security.

## SECURITY TOKENS AND UTILITY TOKENS

This initial guidance from the SEC sparked a debate as to what constitutes a security token: when is a token whose primary purpose is to serve the functionality of the network, a security? Chairman Jay Clayton has stated numerous times at conferences and in speeches that he had not seen a token that was truly a utility, and considered that virtually every token was a security. In general:

1. Security tokens are tokens that are directly related to the growth of the platform, application or the company prior to launch. These are typically seen as being within the purview of securities regulations in most jurisdictions. Notably, if a purpose of the token sale is to create market interest in the platform or application and/or to create a trading platform for the tokens, then it is likely to be considered a security.

2. Utility tokens have, as their primary purpose, a consumptive purpose, that is, some sort of use arising from the sale of the token, to "unlock" or access certain features or functionality on the platform or as a form of scrip or barter that can be used to acquire goods and services on the platform. A token typically cannot be considered a utility until the platform or application has been fully developed and launched.

In a speech at the Yahoo! Finance All Markets Summit in San Francisco, California on June 14, 2018, William Hinman, the Director of the SEC's Division of Corporation Finance, caught the market's attention when he laid out parameters for whether a token should be considered a security:

1. "Is there a person or group that has sponsored or promoted the creation and sale of the digital asset, the efforts of whom play a significant role in the development and maintenance of the asset and its potential increase in value?

2. Has this person or group retained a stake or other interest in the digital asset such that it would be motivated to expend efforts to cause an increase in value in the digital asset? Would purchasers reasonably believe such efforts will be undertaken and may result in a return on their investment in the digital asset?

3. Has the promoter raised an amount of funds in excess of what may be needed to establish a functional network, and, if so, has it indicated how those funds may be used to support the value of the tokens or to increase the value of the enterprise? Does the promoter continue to expend funds from proceeds or operations to enhance the functionality and/or value of the system within which the tokens operate?

4. Are purchasers "investing," that is seeking a return? In that regard, is the instrument marketed and sold to the general public instead of to potential users of the network for a price that reasonably correlates with the market value of the good or service in the network?

5. Does application of the Securities Act protections make sense? Is there a person or entity others are relying on that plays a key role in the profit-making of the enterprise such that disclosure of their activities and plans would be important to investors? Do informational asymmetries exist between the promoters and potential purchasers/investors in the digital asset?

6. Do persons or entities other than the promoter exercise governance rights or meaningful influence?"

Hinman emphasized that tokens and other digital assets can function more like a consumer item than a security, and laid out a list of factors to prompt thinking by issuers and their advisors on this matter in order to commence an informed dialogue with the SEC. These factors are included here because of their significance in evaluating the nature of the token:

1. "Is token creation commensurate with meeting the needs of users or, rather, with feeding speculation?

2. Are independent actors setting the price or is the promoter supporting the secondary market for the asset or otherwise influencing trading?

3. Is it clear that the primary motivation for purchasing the digital asset is for personal use or consumption, as compared to investment? Have purchasers made representations as to their consumptive, as opposed to their investment, intent? Are the tokens available in increments that correlate with a consumptive versus investment intent?

4. Are the tokens distributed in ways to meet users' needs? For example, can the tokens be held or transferred only in amounts that correspond to a purchaser's expected use? Are there built-in incentives that compel using the tokens promptly on the network, such as having the tokens degrade in value over time, or can the tokens be held for extended periods for investment?

5. Is the asset marketed and distributed to potential users or the general public?

6. Are the assets dispersed across a diverse user base or concentrated in the hands of a few that can exert influence over the application?

7. Is the application fully functioning or in early stages of development?"

## SEC NO-ACTION LETTERS

On April 3, 2019, the SEC issued its first no-action to TurnKey Jet, Inc. (TKJ), concurring that, based upon the facts set out in the TKJ request letter, the proposed tokens to be used in a membership program for sale of air charter services were utility tokens created for consumptive use rather than investment. TKJ was permitted to use the tokens subject to certain conditions, including:

- TKJ will not use any funds from token sales to develop the TKJ platform, network, or app, and each of these will be fully developed and operational prior to the time any tokens are sold;
- the tokens will be immediately usable for their intended functionality (purchasing air charter services) at the time they are sold;
- TKJ will restrict transfers of tokens to TKJ wallets only, and not to wallets external to the platform;
- TKJ will sell tokens at a price of one USD per token throughout the life of the program, and each token will represent a TKJ obligation to supply air charter services at a value of one USD per token;
- If TKJ offers to repurchase tokens, it will only do so at a discount to the face value of the tokens (one USD per token) that the holder seeks to resell to TKJ, unless a court within the United States orders TKJ to liquidate the tokens; and
- the tokens are marketed in a manner that emphasizes its functionality, and not the potential for the increase in market value of the token.

A second no-action letter was issued by the SEC on July 26, 2019, to Pocketful of Quarters, Inc., an online video gaming company, allowing the company to issue its "Quarters" to video gamers. The Quarters are described as a "universal gaming token" and an in-game currency having an unlimited supply and fixed price. The conditions outlined in the letter mirror those in the TKJ letter, while also adding an additional condition that the Quarters could only be exchanged by the game's developers and influencers (with approved accounts) for ETH at pre-determined exchange rates. The SEC Division of Corporation Finance's response further provided those developers and influencers with the ability to exchange their Quarters. Developers and influencers are required to undergo Know Your Customer/Anti-Money Laundering checks on an ongoing basis.

Both no-action letters indicate that the SEC is willing to allow a token offering to proceed without registration under the Securities Act, or in reliance upon an exemption therefrom, in the narrow circumstances where, among other things, the tokens are limited to use on a particular platform/network/application and have no external transfer capability or trading market.

## THE EVOLUTION OF THE STO

As regulatory guidance has evolved since early 2017, two key impacts have been recognized. The first is that the days of the "Wild West" (as the ICO market was widely referred to in 2016 and 2017) are over for all savvy market participants. It has become clear that, in the U.S. and most other jurisdictions, compliance with existing applicable law is required. Second, is the distinction between a security token and utility token, which has also resulted in the evolution of the ICO to a "STO," or security token offering.

The STO now takes many forms, but it typically effected as a private placement in reliance upon available exemptions from applicable federal and state securities in the U.S. and applicable securities laws in other jurisdictions. In the U.S., for example, STOs rely upon the Regulation D and Regulation S safe harbors. With a more sophisticated institutional and strategic investor moving into this market, concerns about one-year restrictions on trading or transferability have been broadly dismissed. Such restrictions have become accepted globally as part of the maturing market.

The other approach being commonly pursued by issuers for a STO is through a Regulation A+ offering, requiring that offering materials be "qualified" with the SEC, or a fully SEC-registered initial token offering. In July 2019, the SEC qualified the first token offerings under Regulation A+, approving blockchain startup Blockstack's bitcoin-like digital tokens on July 10, and live video streaming platform YouNow's offering of its "Props" tokens on July 11. These decisions will likely serve as new fundraising templates for many blockchain businesses. While SEC staff have commented at various conferences that a number of Regulation A+ and fully-registered offerings are currently being reviewed confidentially by the Staff, to date none have been qualified or, in the case of a fully-registered offering, declared effective. This is just a matter of time, as issuers and their counsel work through the multitude of custody, settlement and other issues associated with these transactions, and licensed digital custodians and other service providers fill a burgeoning market need.

### *Blockstack*

Blockstack describes its services as being an open-source decentralized computing platform, whose software libraries enable developers to build decentralized applications, that have no single point of failure or control. The company provides decentralized protocols for authentication, data storage, and software distribution.

According to Blockstack's filings on EDGAR, it intends to conduct a cash offering under the Regulation A+, Tier 2, framework. Unlike traditional registered IPO filings, this framework allows the sale of Blockstack's tokens to retail investors as well as to accredited investors and institutions. As part of the offering, an additional supply of tokens is proposed to be allocated to Blockstack's App Mining Program, which rewards developers who create the top-ranked applications within the Blockstack ecosystem.

### *YouNow*

Following on the heels of the Blockstack qualified offering, on July 11, 2019, the SEC approved YouNow's "Props" token offering under the Regulation A+, Tier 2 framework. According to its filings on EDGAR, YouNow has created an Ethereum-based blockchain token, which it intends to distribute to those who create content using its app for activities that "drive community engagement" or as a reward for administration of its own blockchain. The Reg A+ offering also includes a secondary distribution of tokens to be distributed by its affiliated foundation for grants to persons developing key apps or otherwise contributing to the development of the network. The company also said that users will begin to receive tokens for engaging with the platform.

Both offerings are significant in that they establish a basic framework for companies that have sought to issue tokens as rewards for specific platform users and developers. In the past, issuers have attempted to structure such tokens to fall outside the *Howey* test as something other than a security. The Blockstack and YouNow precedents clarify that such attempted structures are unlikely to be acceptable to the SEC in the absence of fact-specific no-action relief. This is not surprising in light of the two recent no-action letters issued by the SEC in TurnKey Jet and Pocketful of Quarters. The SEC draws a clear line between tokens developed for use strictly on a particular platform or "in-app" versus tokens that may be transferred outside the platform or publicly traded on an ATS or other exchange.

## SEC'S FINHUB

As digital assets gain broader acceptance, the SEC continues to look for new ways to work with investors and other market participants on issues such as capital formation and financial services. To this end, the agency recently announced the launch of the Strategic Hub for Innovation and Financial Technology (FinHub), which aims to make it easier for fintech start-ups – including those launching token offerings – to navigate the legal implications of their products. FinHub will act as a central point for the securities regulator to interact with entrepreneurs and developers in the financial technology world, in particular with groups focusing on distributed ledger technology (DLT), automated investment advice, digital marketplace financing and artificial intelligence. The new division will also collaborate with other regulators, both domestic and international, on work that involves emerging technologies. FinHub will be run by the SEC's senior advisor for digital assets and innovation, Valerie Szczepanik, and be staffed by SEC officials who have previously worked on fintech-related issues, according to the agency.

Commenting on FinHub, SEC Chairman Jay Clayton said, "The FinHub provides a central point of focus for our efforts to monitor and engage on innovations in the securities markets that hold promise, but which also require a flexible, prompt regulatory response to execute our mission."

## CONGRESSIONAL PROPOSALS

In April 2019, "The Token Taxonomy Act"[1] was reintroduced in the U.S. House of Representatives, following its initial introduction in December 2018. The bill would amend both the Securities Act of 1933 and the Securities Exchange Act of 1934 to exempt certain cryptocurrencies and other digital assets from U.S. federal securities laws, thereby facilitating the trading of and transactions in select coins. As reintroduced, the bill provides a clearer definition of digital tokens that would be more inclusive of developing technology. The bill would also clarify the tax treatment of virtual currencies held in individual retirement accounts, create a tax exemption for exchanges of one virtual currency for another, and create a de minimis exemption from taxation on gains realized from the sale or exchange of virtual currency for other than cash.

On November 21, 2019, a bill entitled the "Managed Stablecoins are Securities Act of 2019"[2] was introduced in the U.S. House of Representatives, seeking to amending the definition of a "security" under the Securities Act of 1933 to include the term "managed stablecoins." This bill was introduced with another bill, currently untitled,[3] which would prohibit the listing of securities of an issuer if such issuer or one of its directors or executive officers (a) receives compensation I the form of a managed stablecoin, (b) buys or sells a managed stablecoin, or (c) is otherwise affiliated with a person who buys or sells a managed stablecoin after the date of the registration of the issuer's security. For purposes of the draft bills, a "managed stablecoin" means a digital asset that:

(i) Is not a security registered under the Investment Company Act of 1940; and

(ii) Satisfies one or more of the following:

   a. The market value of the digital asset is determined, in whole or in significant part, directly or indirectly, by reference to the value of a pool or basket of assets, including digital assets, held, designated or managed by one or more persons;

   b. One or more holders of the digital assets, directly or indirectly, are entitled to obtain compensation or other assets, including digital assets and any sovereign currency of a foreign government or the U.S., in exchange for the digital assets, the amount of which payment is determined, in whole or in significant part, directly or indirectly, on the basis of the value of a pool or basket of assets, including digital assets, held designated or managed by one or more persons.

The bills have been referred to the House Financial Services Committee for consideration.

## STATE REGULATORS STEP IN.

April 2018 was the beginning of an initiative among United States (U.S.) state securities regulators and provincial securities regulators to crackdown on questionable and potentially risky initial coin offerings ("ICOs") and other crypto-related products. This "Operation Cryptosweep" was a coordinated effort among the North American Securities Administrators Association (NASAA) and across all states, Canada and Mexico. As a result of this initiative, since April 2018, there have been approximately 330 inquiries or investigations involving ICOs or cyptocurrency-related products across the U.S. and Canada. Following recent increases in the value of cryptocurrencies (nearly triple that from April 2018), NASAA published an updated newsletter dated August 7, 2019 concerning its ongoing investigation and crypto crackdown. NASAA noted that the sharp increase in market capitalization for crypto-related products were again creating an environment that attracts white-collar criminals, bad actors, and other promoters of illegal and fraudulent securities schemes. Since the beginning of 2019, there have been about 130 new investigations into questionable activities and crypto-related investment offerings and more than 85 enforcement actions involving ICOs and cryptocurrencies reported in the last year alone.

As part of the on-going initiative of Operation Cryptosweep, Alabama, California, Delaware, Maryland, Minnesota, Missouri and Vermont are among the states that have joined the effort to crackdown on potential fraudulent offerings and the rise in cryptocurrency-related scams, joining the already active states of New Jersey, New York,[1] Ohio, Oregon, Texas and Washington in aggressive enforcement efforts. Each of these states have issued cease-and-desist orders for the failure of companies to register their cryptocurrency offerings (e.g. unregistered securities in the form of a cryptocurrency token), or claim a viable exemption, or noting the failure to engage a registered dealer in the public offerings of crypto-related investment products. Most talked about are:

- In California, allegations that Ripple Labs engaged in unregistered securities public offering of XRP, a cryptocurrency (in exchange for fiat currency), and violated registration requirements under federal and state securities laws.

- Florida's continued hostile view to blockchain and virtual currency industry where, in State v. Espinoza, the appellate court ruled that state money transmitter laws apply to the sale of digital currencies. The court held that bitcoin is a "payment instrument" because individuals were willing to accept bitcoin in exchange for goods & services. This is in contrast to Office of Financial Regulation, which stated that parties who buy their own bitcoin do not need to obtain money transmitter license.

- Texas went so far as to require a rescission offer to Texas residents who invested in the cryptocurrency offering.

At a glance, the 2019 legislative and regulatory activity relating to cryptocurrencies and blockchain has been active.

a. Working Group/Task Force: The following 20 states have added legislation to authorize a working group to study the technology and/or the definition of blockchain and/or smart contracts, and to issue a report of recommended policies to foster the expansion of the blockchain industry: Alabama, California, Colorado, Florida, Illinois, Indiana, Kentucky, Louisiana, Maine, Massachusetts, Nevada, New Jersey, New York, North Dakota, Oregon, Texas, Vermont, Virginia, West Virginia, and Wyoming.

b. Blockchain/Cryptocurrency Legislation: In the area of securities, the following states have either introduced or passed legislation, executive orders, and/or regulations relating to exceptions or limited exemptions from qualification under the state securities laws for tokens or cryptocurrencies: Arizona, California, Hawaii, Indiana, Iowa, Missouri, Montana, Nevada, North Dakota, Oklahoma, Rhode Island, South Carolina.[2] and Wyoming.

c. Money Transmission: a. With the exception of Arizona, Arkansas, Delaware, District of Columbia, Iowa, Kentucky, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Jersey, North Dakota, Oklahoma, South Carolina, South Dakota, and West Virginia, which are generally silent on any licensing requirements for digital currency transmission, all other states have some form of money transmitter license or other agreement requirement for some cryptocurrency activity, have issued guidance if engaging in some activity involving cryptocurrency, or proposed action for a virtual-currency businesses act (in particular, some recent [ ] in Hawaii, Kansas, Maine, and Maryland, Nevada, Washington), in connection with digital currency transmission.

d. Marketplace Facilitator: Further, there has been an increase in state proposed legislation to add to definition of "Marketplace Facilitator" providers of a virtual currency that buyers are allowed or required to use to purchase products from a seller (generally for the purposes of the sales/use tax). In 2019, the states of California, Colorado, Maryland, Massachusetts, Nevada, New Jersey, North Dakota, Ohio, Rhode Island, Utah, Vermont, Virginia, and West Virginia.

The following are among the most noteworthy state legislation and/or regulation directing offerings of crypto-related investment products thus far in 2019:

### A. CALIFORNIA

Department of Business Oversight has not decided whether to regulate digital currency/virtual currency transmission under California's Money Transmission Act. However, there has been other activity in this area. In addition to establishing an Office of Digital Innovation within the Government Operations Agency:

1. California Consumer Privacy Act of 2018 (CCPA) becomes operative January 1, 2020—adds Title 1.81.5 to Part 4 of Division 3 of the Civil Code relating to privacy. Under this Act, businesses subject to the CCPA must

    ◦ Provide California residents, regardless of whether they are located in California at the time of collection, with notice about the personal information collected about them, with whom it is shared, and if the information is shared for money or other valuable consideration.

    ◦ Respond to California residents' requests to disclose, and subject to a verified request, disclose the categories and specific pieces of personal information that it collects about the consumer, the categories of sources from which that information is collected, the business purposes for collecting or selling the information, and the categories of third parties with which the information is shared.

2. California AB-1489 was introduced in February 2019, and would enact the Uniform Regulation of Virtual Currency Businesses Act, requiring anyone from engaging in virtual currency business activity, or holding itself out as doing the same, without registration with the Department of Business Oversight or conducting such activity pursuant to an exemption from registration. The term "virtual currency business activity" is defined as exchanging, transferring, or storing virtual currency or engaging in virtual currency administration, whether directly or through an agreement with a virtual currency control services vendor, among other things. The Act would also provide provisions for the recognition of a similar license issued from another state.[3] If enacted, the Act would be operative January 1, 2020,

3. California SB-838 will allow for the use of blockchain technology for corporate recordation purposes, including recording all issuances and transfers of stock of a corporation.[4] If enacted, the Act would be operative January 1, 2022.

### B. COLORADO

Effective Aug. 2019, Colorado enacted the Digital Token Act (Act) which explicitly addresses digital tokens and facilitates the sale and transfer of digital tokens within Colorado. The Act provides a transactional exemption from securities registration for offerings involving qualifying digital tokens, and permits Colorado businesses to effect transactions involving the sale and transfer between certain persons of digital tokens secured through a decentralized ledger or database, with a focus on the production, distribution, and consumption of goods (also known as a "cryptoeconomic system"), as opposed to the current centralized internet platforms and applications that serve as intermediaries of such transactions in cryptocurrencies. Subject to certain conditions, including pre-offer notice filings, not only are these transactions exempt from the securities registration requirements under the Colorado Securities Act (CSA), but persons dealing in these digital tokens will be exempt from the securities broker-dealer/salesperson licensing requirements under the CSA. Implementation of the Act is further conditioned on the Securities Commissioner (Commissioner) adopting rules as necessary to implement the provisions of the CSA; none adopted to date.

- Implementation of the Act is further conditioned on the Securities Commissioner adopting rules as necessary to implement the provisions of the CSA; none adopted to date.

- <u>Transactional Exemption:</u> To qualify for an exemption under Section 51-3.34 of the Act, the offer and sale of the digital token must meet the following conditions:

    1. the offer or sale occurs after, and complies with, rules promulgated by the Commissioner to implement the Act;

    2. for digital tokens issued on or after Aug. 1, 2019, issuer must provide notice of exemption on Form DT-1 prior to issuance (notice also must be provided if issued before Aug. 1, 2019); and

    3. <u>either:</u>

    a. the consumptive purpose can be realized at the time of offer and sale of the digital token; <u>or</u>

    b. <u>all of the following are met:</u>

        i. the consumptive purpose will be available within 180 days of sale or transfer of the digital token;

        ii. the initial buyer is prohibited from reselling or transferring the digital token until the consumptive purpose of the digital token is available; and

iii. the initial buyer provides a clear acknowledgement that the primary intent of its purchase is to use the digital token for a consumptive purpose.

- Broker-Dealer/Salesperson Exemption: Pursuant to Section 51-3.35, any person that engages in the business of effecting or attempting to effect the purchase, sale, or transfer of a digital token is exempt from the licensing requirements of Section 11-51-401 of the Act if, among other conditions: (i) effects or attempts to effect such transactions after promulgation of rules to implement the Act; (ii) such person files a notice of intent on Form DT-2 prior to an offer; and (iii) the person takes reasonably prompt action to cease effecting the transaction if not in compliance with the licensing exemption requirements.

### C. MONTANA

Montana is the third Rocky Mountain state (after Colorado and Wyoming) to pass blockchain-related legislation. The "Generally Revise Laws Relating to Cryptocurrency" Act went into effect July 1, 2019 and is codified as a transactional exemption under Section 30-10-105(23) of the Montana Securities Act. Section 30-10-105(23) exempts blockchain-based utility tokens from securities laws so long as the tokens have a "primarily consumptive" purpose. The Act defines "consumptive purpose" as having a primary aim to "provide or receive goods, services, or content, including access to goods, services, or content." The issuer of the tokens cannot market them as an investment or for speculation. The Act provides that tokens that qualify for the exemption (i.e. the consumptive purpose of the utility token) must be available no more than 180 days after their date of sale or transfer of such utility token, and initial buyers of the tokens are not permitted to transfer the tokens until their consumptive purpose is available. Prior to the tokens being offered for sale, the issuer must file a notice of intent to sell them with the state's securities commissioner. Additionally, while utility tokens are now exempt from the state securities law, the issuers of such tokens still have to notify the securities commissioner, and must file certain disclosures in the state in order to sell such tokens. Such notice must be amended within 30 days for any information previously disclosed that becomes inaccurate in any material respect for any reason. The Act terminates September 30, 2023.

### D. WYOMING

Wyoming has enacted a series of pro-blockchain regulations in 2019 designed to exempt "utility tokens" (also known as "open blockchain tokens") from the state money transmission laws provided (i) the token must not be offered as an investment; (ii) the token must be exchangeable for services and goods; and (iii) the token issuer or developer must not deliberately make efforts to find a secondary market for the token.

**Enacted/Blockchain. Wyoming has enacted a series of regulations designed to exempt "utility tokens" (also known as "open blockchain tokens") from the state money transmission laws provided (i) the token must not be offered as an investment; (ii) the token must be exchangeable for services and goods; and (iii) the token issuer or developer must not deliberately make efforts to find a secondary market for the token.**

(1) House Bill No. HB0185 will permit companies to issue digital or "certificate tokens" in lieu of stock certificates, declaring that the words share certificate, share, stock, share of stock or other similar words to also include a certificate token and certificated shares or similar words to include shares represented by certificate tokens.

(2) Senate File No. SF0125 will allow for banks to provide custodial services for a range of digital assets, including virtual currencies (such as bitcoin and ether), digital consumer assets (utility tokens, including those used to purchases goods and services), and digital securities.

(3) Enacted/Blockchain. HB 62 – (i) establish that open blockchain tokens with specified characteristics are intangible personal property & not subject to a securities exemption; & (ii) require developers & sellers of open blockchain tokens to file notices of intent & fees.

(4) Proposed HB 0185, to create special purpose depository institutions as a new financial institution to provide access to banking services for digital assets by blockchain innovators.

### WHAT'S NEXT FOR TOKEN OFFERINGS?

Securities regulators and governments have made a concerted effort to help expose the risks and fraud involved in crypto-related offerings to the public and offer more clarity to the digital asset market. Like the SEC and CFTC, FINRA established a Fintech Hub to consider novel fintech issues by member firms. In addition, based on findings of a FinTech Industry Advisory Panel, the State Conference of Bank Supervisors (SCBS) proposed for comment a money services businesses model law intended to be adopted by state regulators, and to apply to money services companies operating or seeking to operate on a national scale. Intended to harmonize and make transparent the treatment of common exemptions for certain activities across the states. On the state level, additional states are adopting legislation to establish working groups or committees to study the emergence and integration of blockchain technology in the state; more states have proposed legislation to add to the definition of "Marketplace Facilitator" providers of a virtual currency that buyers are allowed or required to use to purchase products from a seller (generally for the purposes of the sales/use tax). While most state legislation appears to focus on the individual state's Money Transmitter Act and requiring a license if receiving monetary value for transmission involving some cryptocurrency activity, this state activity is a strong indicator of a growing concern to educate the public on the various issues that continue to surround ICOs and crypto-related investment schemes.

## FOOTNOTES

[1] https://www.govtrack.us/congress/bills/116/hr2144/text.

[2] H.R. 5197.
https://sylviagarcia.house.gov/sites/sylviagarcia.house.gov/files/wysiwyg_uploaded/Managed%20Stablecoins%20are%20Securities%20Act%20of%202019%20Bill%20Text_3.pdf.

[3] https://financialservices.house.gov/uploadedfiles/bills-116pih-listingofsecurities.pdf.
The bills have been referred to the House Financial Services Committee for consideration.

[1] The New York Department of Financial Services (NYDFS) recently created the Research and Innovation Division which will be responsible for licensing and supervising virtual currencies, as well as reviewing new technology for the financial services marketplace in New York. This newly created Division will also handle Bitlicense applications for companies buying, selling, or issuing cryptocurrency to New York residents.

[2] AZ (HB 2601 signed by governor); HI (re-referred HB 70); IN (introduced SR 9); IA (introduced HF 240); MO (introduced HB 1109); NV (introduced SB 195, subject to modification); OK (introduced SB 843/HB 1954); RI (introduced HB 5776/5595/5598); SC (introduced SB 738/HB 4351).

[3] The Act would add Chapter 7 (Section 8701 et seq) to the Commercial Code, and Division 1.25 (Section 3101 et seq) to the Financial Code, relating to virtual currency businesses.

[4] This Act adds Sections 204 and 2603 to the California Corporations Code.

*This article first appeared in Westlaw's publication entitled Payment Systems and Electronic Fund Transfers Guide. The publication is part of the Emerging Areas of Practice Series – a new publishing initiative which reduces product to market time to cover emerging areas of the law as they develop. New documents are loaded to Westlaw on a rolling basis as received and content is updated quarterly.*



## ABOUT THE AUTHORS

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