Wall Street Blockchain Alliance - Legal Working Group
Response to the Securities and Exchange Commission Staff's April 2019 Digital Asset Guidance

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On April 3, 2019, the U.S. Securities and Exchange Commission's (the "**SEC**") staff ("**Staff**") released a "Statement on Framework for 'Investment Contract' Analysis of Digital Assets" (the "**Statement**"), announcing the (i) SEC's Strategic Hub for Innovation and Financial Technology's ("**FinHub**")[1] publication of staff guidance in the form of a Framework for "Investment Contract" Analysis of Digital Assets (the "**Framework**"), and (ii) the SEC's Division of Corporation Finance's (the "**Division**") release of a no-action letter related to the proposed offer and sale by TurnKey Jet, Inc. ("**TurnKey**") of a blockchain-based token (the "**No-Action Letter**" and, together with the Framework, collectively, the "**Guidance**").[2]

While the SEC's release of the Guidance marks a welcome attempt on the part of the Staff to provide greater clarity as to the applicability of U.S. federal securities regulation to digital assets, in the view of those Wall Street Blockchain Alliance (the "**WSBA**") Legal Working Group ("**LWG**") members named at the end of this Paper ("**we**," "**us**" or "**our**"), the Guidance represents more of a consolidation of previously enunciated positions, rather than an expansion of prior guidance expressed by the SEC and many key members of its Staff. Consequently, generally, in analyzing whether the offer or sale of a digital asset sold as part of a fundraising for the development, expansion or popularization of a blockchain-based platform is subject to compliance with U.S. federal securities laws market participants should continue to begin with the assumption

[1] FinHub recently formed within the SEC in October 2018 as a "resource for information about the SEC's views and actions in the FinTech space."

[2] In addition, we note that FinHub's Chief Legal Advisor, Jonathan Ingram, signed, on the Division's behalf, the No-Action Letter.

that the sale likely will be deemed by the Staff to involve the offer of an investment contract and, thus, is deemed to be a security under U.S. federal securities laws.

Despite providing greater insight concerning the Staff's approach to analyzing whether the sale of a digital asset that otherwise would not be considered debt, equity, or another type of more traditional security nevertheless constitutes an investment contract and, hence, a security, it is our view that, generally speaking, the Guidance is unlikely to materially change the legal guidance that responsible legal practitioners provide to a client seeking to launch a digital asset transaction in the absence of the Guidance. Although the Staff must be applauded for its efforts, the Guidance does raise many new questions.

Selected Take-Aways, Questions and Recommendations:

(1) **The Framework Makes It Clear that It Is Not the Last Word**. The Framework explains that (i) it represents the views of FinHub and **<u>is not</u>** an SEC rule, regulation, or statement, and (ii) the SEC has neither approved nor disapproved the Framework's content.[3] The Framework does not replace or supersede existing case law or legal requirements. The Framework's guidance is non-binding, and there can be no assurance that the SEC, including its Enforcement Division, or courts will accept the Staff's views without change. The SEC does have the power to establish formal rules that are legally binding on participants and, if it wished to, could establish such rules. In fact, as explained by SEC Chairman Clayton in September 2018, "[….] [I]t is the [SEC] and only the [SEC] that adopts rules and regulations that have the force and effect of law."

(2) **The Guidance does not change the starting assumption that, in the eyes of the Staff, in a significant number of cases, a transaction involving a digital asset that is not clearly a traditional security (e.g., stock or a note), nevertheless is a transaction involving an investment contract and, hence, a security**. As the Framework itself makes clear, "[T]his framework does not replace or supersede existing case law, legal requirements, or statements or guidance from the Commission or Staff. Rather, the framework provides additional guidance in the areas that the Commission or Staff has previously addressed."

(3) **Engagement with FinHub, preferably together with legal counsel experienced in the digital asset space, remains, in many cases, a critical first step for persons seeking to effect a transaction in digital assets that is not intended to constitute a securities transaction**. We recommend that such engagement with FinHub take place prior to commencing any such transaction.

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[3] The same applies, for example, to the non-exhaustive factors expressed in Director William Hinman's 2018 speech, "When Howey met Gary (Plastic)." The industry should be particularly careful when attributing an SEC employee's (e.g., Director, Division, Staff, etc.) statement to the SEC as a whole.

(4) The "*Howey* Test"[4] remains the primary applicable test for whether, under U.S. federal securities laws, a digital asset constitutes a security in the form of an investment contract. We note that, in subsequent litigation, the U.S. Supreme Court and lower U.S. federal courts have continued to refine the *Howey* test, and, on certain issues, court precedent is divided. As set out by the Supreme Court, the *Howey* test requires that four separate elements (or "prongs") are met in order for a transaction purporting to be a commercial sale or similar arrangement to be considered an "investment contract".

(5) The Framework asserts that prongs 1 and 2 of the *Howey* test (i.e., "the investment of money" and "common enterprise," respectively) are typically satisfied in the context of a digital asset transaction. The Framework provides no additional discussion concerning these two prongs, but questions remain, including those set forth below. In our view, practitioners should not assume that prongs 1 and 2 of the *Howey* test are satisfied and these prongs should continue to be analyzed on a case-by-case basis.

a. *Howey* Prong 1: Investment of Money. The Framework (in FN 9) explains that both "bounty programs" and "air drops" involve "disposition for value," constituting an investment of money, in the form of non-cash consideration. Yet "bounty programs" and "airdrops" vary and must be analyzed on a case-by-case basis. Indeed, in the SEC's Tomahawk Cease-and-Desist Letter, the Staff determined that under Tomahawk's "bounty program," the "gifting" of TOM Tokens to those who marketed such digital assets, constituted a sale of securities, because Tomahawk obtained real benefits or value in exchange for the digital asset "give-away." Importantly, however, the TOM Token was equity-linked, and the Staff cited precedent from early internet cases, which, themselves, involved "gifts" of equity.

If an issuer of a digital asset conducts an airdrop or bounty program, the Tomahawk action is an important reminder that the giveaway of a security, even if the issuer does not receive from recipients actual payment in the form of fiat or crypto currency, nevertheless may be a sale of that security if the recipients provide any type of services or other benefits to the digital asset issuer in return, including the mere creation of a public market for the digital asset. However, if, with the assistance of counsel (and preferably in conjunction with discussions with FinHub), a determination is made that the digital asset sale in question does not constitute an investment contract, then, in our view, making the digital asset available to recipients through an airdrop or bounty program would not, in and of itself, necessarily create an investment contract. In our view, the determination of (i) whether an investment contract or other security exists, and (ii) whether the purported gift of such security actually constitutes a sale, are two distinct inquiries and should not be collapsed into one level of analysis. In any event, in our view,

[4] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

the "investment of money" analysis requires an examination of the reasonable expectation of the purchaser as to whether it is acquiring a security. *See* item 9, below.[5]

b. ***Howey* Prong 2: Common Enterprise**. The Framework (in FN 10) specifies that, despite the case law requirement that either "horizontal commonality" or "vertical commonality" exist in order to satisfy the *Howey* test's "common enterprise" prong, the SEC does not view a "common enterprise" as a distinct element of the term "investment contract" and, hence, has no such requirement. Nevertheless, until we see a trend of judicial decisions questioning the relevance or necessity of the "common enterprise" prong of *Howey*, we believe that it should still be considered a pertinent element to any *Howey* analysis." Existing case law suggests that ownership of a common asset whose value rises and falls depending on market forces does not, by itself, give rise to a "common enterprise" for *Howey* test purposes.[6]

(6) The existence of one or more "Active Participants" is relevant to whether an investment contract exists under U.S. federal securities law. In his landmark 2018 speech, "When *Howey* Met *Gary* (Plastic)," William Hinman, Director of the SEC's Division of Corporation Finance, discussed factors to consider when assessing whether a digital asset sale involves the sale of a security. He advised that one should consider whether a "third party – be it a person, entity or coordinated group of actors - drives the expectation of a return." In the Framework, the Staff has gone a step further by formalizing for the first time the concept of an "Active Participant" (an "**AP**") in the digital asset context.

When considering whether purchasers of digital assets have an "expectation of profits" based on the "efforts of others," the Framework introduces to this prong of the *Howey* test analysis the AP concept, which the Framework defines to include "a promoter, sponsor, or other third party (or affiliated group of third parties)." The Framework explains that when an AP provides "essential managerial efforts that affect the success of the enterprise," the third and fourth prongs of the *Howey* test likely will be satisfied. In our view, it is hard to imagine situations in which APs would not be involved, at least to some extent, in the development or ongoing support of a digital asset that is intended to be a functional part of a decentralized or decentralizing blockchain-based platform. Therefore, the formal introduction of the expansive AP concept adds to the *Howey* analysis a new and, arguably, subjective test requiring a determination as to (i) whether one or more parties are acting as APs in connection with the "enterprise" associated with the digital asset, (ii) whether the efforts of such AP or APs are "essential" to the success of that enterprise and, if so, (iii) whether, but for such essential efforts, the enterprise would not be successful. As a

[5] *SEC v. Cross Financial Services, Inc.*, 908 F. Supp. 718,728 (C.D. Cal 1995) and text accompanying note 10.

[6] Similarly, the Framework suggests that mere price fluctuation caused by market forces likely would not, by itself, constitute "profit" within the meaning of the *Howey* test.

result of adding this expansive concept, we believe that there is a much higher likelihood of finding that the "reliance on the efforts of others" prong of the *Howey* test has been satisfied in the digital asset sale context.

Given the AP's prominence in the Framework (and pending any further clarification which may arise out of judicial decisions or more formal SEC rulemaking or other action), it is critical for the market to develop a nuanced understanding of when a certain person's, entity's or affiliated group's activities would qualify it as an AP, or as a "successor" AP, and whether such activities are essential to the digital asset's success.

Critical to the above analysis is a better understanding of what the Staff considers to be the "enterprise" when discussing the role of an AP in a digital asset transaction. For example, in many sales of digital assets in the form of tokens that are intended to comprise part of a decentralized or decentralizing blockchain platform, there will be a sponsor entity developing the software that will form the basis of the blockchain-based platform.

In many cases, this entity is a traditional business or "enterprise" with shareholders who have an economic stake in the success of the business. This entity will often retain a significant portion of the digital assets to be sold and will continue to act as the catalyst and "champion" for use of the platform, once the platform has been launched (although these platforms are typically open-sourced, with further development and refinement of the software left to a community of interested users that would generally include the sponsor).

However, because purchasers of the digital assets (tokens) relating to a platform developed by such a sponsor entity typically will have no direct or indirect interest in that sponsor entity (and, thus, no interest in the "success" of that enterprise), it would not appear that this is the "enterprise" being referred to in the Framework. An alternative reading is that the "enterprise" being referred to is the blockchain platform itself. In most decentralized or decentralizing blockchain platforms, a finite number of tokens are created, and it is intended that the value of these tokens will increase along with the demand for use of the platform to which the tokens relate. This raises a different question – whether the platform itself is an "enterprise" in any currently understood sense or rather a software protocol (computer code). The platform is not any sort of recognized legal entity. Most importantly, the software protocol will continue to exist and have utility for so long as some minimum number of computers somewhere in the world are running the code.

We also note that many so-called decentralized systems seek to use a coordinating body (sometimes, a foundation) in addition to, or in lieu of, a traditional corporate enterprise in order to enable stakeholders of the system to have coordinated engagement. This raises a question as to whether (i) the existence of a decentralized system means that there is no longer an "enterprise," (ii) such a coordinating body would, itself, be considered to constitute the enterprise or (iii) regardless of whether an "enterprise" still exists, there no longer is an identifiable AP that is performing an essential function. In some cases, all (or a subset of) stakeholders elect the members of the coordinating body or foundation. In other cases, the members of the governing body or foundation may be appointed by the original digital asset sponsor. Such coordinating bodies also exercise different levels of control and oversight, some playing passive roles and others acting in a fashion similar to a traditional corporate management team. Accordingly, even in cases where a digital asset system claims to be decentralized, the existence of a foundation or similar coordinating body that is playing an essential role with respect to the future success of the digital asset, could result in that foundation or body being deemed to be an AP.

(7) **The Framework takes the position that, in certain circumstances, digital assets may be "mutable" and may transition from securities to non-securities**. The Framework reaffirms statements made by Director Hinman in his landmark speech suggesting that, in certain limited situations, sales of digital assets may constitute sales of securities at one point in time (e.g., their initial sale), but that, at a later point, subsequent sales of the same digital assets may no longer constitute securities transactions (or, at the very least, that the policy considerations no longer exist for continuing to treat the purchase and sale of such digital assets as the purchase and sale of securities). In our view, the Framework's "mutability" discussion results in the following take-aways:

a. **Sufficient decentralization may not be enough**. In his speech, Director Hinman suggested that "sufficient decentralization" of a network and then-present functionality of a digital asset intended for consumptive use were factors to be considered when assessing whether a digital asset sale may no longer be the sale of a security. Following that speech, market participants and their lawyers had many questions about how to determine whether "sufficient decentralization" of a given network had been achieved. The Framework, however, does not explicitly adopt the "sufficiently decentralized" standard in the manner discussed in Director Hinman's speech. Instead, the Framework seems to imply that a decentralized network may be found to exist when there are no longer "essential tasks or responsibilities performed and expected to be performed by an AP." The Framework suggests a variety of non-exhaustive factors and examples for consideration when "evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales." Such factors primarily address the ongoing role, if any, of an AP.

The Framework recognizes court precedents that attempt to distinguish when an asset is being purchased for consumptive purposes, rather than with an expectation of profit. Among the considerations that the Framework suggests may be relevant are: (i) whether the distributed ledger network and digital assets are fully developed and operational; and (ii) whether digital asset holders are immediately able to use such digital assets for their intended functionality on the network.

In our view, such concepts may be read as complementing the decentralization concept from Director Hinman's speech. However, it is unclear to us how market participants would, at any given time, be able to determine whether most purchasers of a digital asset were acquiring them primarily for consumptive purposes, rather than with an expectation of profit or if, at the time of purchase, one or more APs continue to play a role with respect to such digital assets. Such a determination would be necessarily made on a case-by-case basis and it is foreseeable that there could be different conclusions reached at different times. Even when a particular AP (such as the initial sponsor of the network) publicly announces that it is no longer providing the "essential managerial efforts" to that network, it is possible that this position might change in the future, whether due to a change in the activities of that AP or because of activities of another person or entity that may become an AP. In addition, different market participants may have access to different amounts of information about either the network, the activities of some or all APs or all of the above. All of these factors combine to make it difficult to apply this standard in practice.

b. **Market participants and their lawyers should proceed cautiously when reasoning that an investment contract at some time in the future may not be a security**. By virtue of the facts-and-circumstances analysis proposed by the Staff, there is no bright-line basis by which market participants or their lawyers can make the determination, on a forward-looking basis, that purchases and sales of digital assets originally deemed to be an investment contract would no longer constitute the purchase and sale of securities. In addition, the Framework adds to the analysis additional complexity, by never explicitly stating that a digital asset that was security at the time of its initial sale actually could cease to be a security. Instead, the Framework discusses "whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales." This could be read to suggest that, if a digital asset is a security when first sold, it will always be so, but that, at a future date, policy reasons may no longer exist for continuing to treat purchases and sales of such digital asset as transactions in securities. If that is the case, it may be difficult for legal counsel to advise their clients that such clients may discontinue applying U.S. federal securities laws to transactions in a given digital security without first consulting with the Staff. Further, the Framework also suggests that a digital asset sale that no longer constitutes the sale of a security could, under certain circumstances, later revert back to the sale of a security. It also should be noted that in his speech, Director Hinman emphasized that in determining whether an investment contract is being sold requires consideration of *how* the asset is being sold and whether an asset that, standing alone, would not be a security (such as a housing unit or a certificate of deposit) might be part of an "investment contract" if sold together with management services or an arrangement which promises liquidity[7]. Applying these principles in any particular case requires a careful analysis of all the facts and circumstances presented.

For these reasons, it is our view that the concept of "morphing" is likely intended to be a narrow exception and that market participants, through their lawyers, absent seeking no-action relief, in most cases should engage in discussions with FinHub to seek guidance, rather than assuming that any digital asset sale has "morphed" and thus become the sale of a non-security.

c. **No authority cited for continuing to treat tokens as "securities" after they have been sold to third parties**. While there is plenty of authority, both in the *Howey* case and its progeny (including the *Gary Plastic* case frequently cited by the SEC), to support that an object or instrument that is not in and of itself a "security" (such as orange groves, bank certificates of deposit, barrels of whiskey, or animals such as beavers, silver foxes or chinchillas), can be offered and sold in conjunction with a fundraising scheme that creates a "investment contract" and, thus, a "security," there is no identified legal authority that stands for the proposition that such a "non-security" object, when disassociated from the relevant fundraising scheme and sold to a third party, somehow retains its character as a "security." We recognize that the types of digital assets that are covered by the Framework are highly unique assets and that case law applicable to physical assets, such as the above, may not necessarily apply. Nevertheless, in our view, it is important to acknowledge that how this important issue is addressed will have an impact on the future viability of many digital asset projects. Other than potentially in the real estate context,[8] we are unaware of any case law or regulatory pronouncement that has found that a "de-coupled" asset retains its character as a security in the digital asset context.

(8) Virtual Currencies may warrant separate treatment. The Framework briefly discusses virtual currencies but does not define what constitutes a "virtual currency." Among other things, the Framework notes that, in the case of a digital asset described as a virtual currency that; (i) can be used immediately to make payments in a wide variety of contexts or acts as a substitute for fiat currencies; and (ii) acts as a store of value, the consumptive nature of such virtual currency might make the *Howey* test inapplicable.

In our view, the Staff's acknowledgment of the existence of a virtual currency category of digital assets reinforces the idea that the Staff recognizes that not all digital asset sales are sales of securities. Merely labeling a particular digital asset as a virtual currency does not

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[7] *See United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) and *Gary Plastic Packages Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230 (2d Cir. 1985), respectively.

[8] Arguably, the *Forman* decision and the SEC Guidelines as to the Applicability of the Federal Securities Law to Offers and Sales of Condominiums or Units in Real Estate Development, SEC Rel. No. 33-5347 (Jan. 4, 1973), implicitly, if not explicitly, addressed this issue in the real estate context.

make it so, however. Until we have greater insight concerning the definition of virtual currency, legal counsel is in a challenging position when advising clients regarding when a digital asset may properly be classified as a virtual currency. We do note, however, that, in the SEC's 21A Report of Investigation concerning The DAO,[9] the SEC referred to Ether (the native token of the Ethereum blockchain) as a virtual currency, based on the definition of virtual currency issued in 2014 by the Financial Action Task Force.[10,]

(9) Assessing whether digital asset holders expect to have the protections of the U.S. federal securities laws is relevant to determining whether a security exists – and is supported by legal precedent. Legal precedent exists for asking whether digital asset purchasers reasonably expect to receive U.S. federal securities law protection. *Reves v. Ernst & Young*.[11] In *Reves*, which concerned a financial instrument (a note representing a debt obligation), the U.S. Supreme Court considered the reasonable expectations of the investing public as one of four (4) factors, when determining whether those notes constituted securities[12].

Taking into account the facts and circumstances presented in each case - including statements made by the issuer of a digital asset, a conclusion that the purchasers of the digital asset (particularly one that, unlike the notes in *Reves*, has no financial features) would not reasonably expect the protections of the federal securities laws in connection with the purchase, would provide strong support for the argument that the asset should not be deemed a security. Indeed, in his speech, Director Hinman noted that "Central to determining whether a security is being sold is how it is being sold and the reasonable expectations of purchasers."

Another relevant consideration cited in *Reves* is whether some factor, such as the existence of another regulatory scheme significantly reduces the risk of the asset and mitigates against the need for the protection of the securities laws. In the digital asset context, this factor, arguably, would be satisfied because if a digital asset is not a security, it likely would be regulated under the Commodity Exchange Act or under federal or state consumer protection laws.

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[9] See SEC Release No. 81207, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (July 25, 2017), available at https://www.sec.gov/litigation/investreport/34-81207.pdf.

[10] FATF Report, Virtual Currencies, Key Definitions and Potential AML/CFT Risks, FINANCIAL ACTION TASK FORCE (June 2014), http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential- aml-cft-risks.pdf. A virtual currency is defined as "a digital representation of value that can be digitally traded and functions as: (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency," "real money," or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency." It is notable, though that ETH could well be considered a "utility" or "consumer" token as it has as its ostensible primary purpose, the utility of being used to pay miners for contributing the "computer" power needed to run the Ethereum Virtual Machine (this is called the "gas" cost of a smart contract in Ethereum parlance).

[11] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

[12] 494 U.S. 56 at 66.

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Consideration of these *Reves* factors in applying the *Howey* test should not be regarded as a partial rejection of *Howey*. These factors are merely relevant facts and circumstances that should be integrated into the *Howey* analysis. In the digital asset context, the SEC applies a facts-and-circumstances analysis to each digital asset transaction to determine whether it is a securities transaction.[13]

(10) One should not assume that investment contracts are "equity securities" for purposes of Section 12(g) of the Exchange Act. Both the Exchange Act and the Securities Act of 1933 (as amended, the "**Securities Act**") define "security" to include a laundry list of subcategories, among them equity and investment contract.

However, we believe that it is critical to distinguish between the mere existence of some kind of a security (whether as a result of satisfying the definition of investment contract or another security subcategory) and the specific existence of an equity security. It is inappropriate to assume that every investment contract constitutes an equity security, including for purposes of Section 12(g) of the Exchange Act. Indeed, it is helpful that Rule 3a11-1 under the Exchange Act, which defines "equity security" for purposes of Section 12(g) and 16 of the Exchange Act, does not include in its list of instruments an "investment contract." However, we would caution that the critical question is the actual characteristics of the commercial arrangement between the seller and purchaser and any undertakings (express or implied) made in connection with the sale of the digital asset.

Existing case law supports this distinction. In *Timber Co. v. Landreth*, 471 U.S. 681 (1985), which involved the sale of stock as part of the sale of an entire business, the Supreme Court identified several characteristics traditionally associated with stock: (1) negotiability; (2) the ability to be pledged or hypothecated; (3) voting rights in proportion to the number of shares owned; and (4) the ability to appreciate in value. 471 U.S. at 686 (citing *Forman*, 421 U.S. 837 (1975)).

The question of whether a security, irrespective of whether it has the features of an investment contract, should properly be considered an equity security has particular relevance in the digital asset sale context, especially given the Staff's position that many digital asset sales constitute the sale of investment contracts. For instance, if digital assets sold as part of an investment contract constituted the sale of equity securities, Section 12(g) of the Exchange Act, which "establishes the thresholds at which an issuer is required to register a class of securities" with the SEC, must be considered.[14]

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[13] Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs, 115th Cong. 4 at 37 (2018) (Statement of Jay Clayton, Chairman, SEC).

[14] "[….] [A]n issuer that is not a bank, bank holding company or savings and loan holding company is required to register a class of equity securities under the Exchange Act if: it has more than $10 million of total assets; and the securities are "held of record" by either 2,000 persons, or 500 persons who are not accredited investors. [A]n issuer is not required to register a class of equity securities pursuant to Section 12(g)(1) if on the last day of its most recent fiscal year: the issuer had total assets not exceeding $10 million; or the class of equity securities was held of record by fewer than 2,000 persons or 500 persons who are not accredited investors (as such term is defined in Securities Act Rule

However, if the arrangement did not involve the sale of an equity security, then some of the more onerous obligations of the Exchange Act would not apply (e.g., transfer agent requirements).[15] This would help address some market concerns that characterizing digital asset sales as sales of securities would be harmful to, and materially stifle, the development and adoption of digital assets, as well as existing projects (although some of the most critical regulatory burdens, such as the requirements for the use of broker-dealers and the limitation of trading of the digital assets to only venues approved for use in connection with sales of securities would still apply).

It is our view that not every sale of a digital asset that is a security should be deemed an equity security or subject to Section 12(g) of the Exchange Act.[16]We are of the view that if a digital asset is not intentionally structured as a digitized equity or debt security (and, in particular, does not have the economic or governance characteristics of equity securities noted above), but nevertheless appropriately falls within the broader definition of security, then generally it should not be considered an "equity security" for purposes of Section 12(g), as noted above.

However, we note that in the Airfox, Paragon and Gladius Network enforcement actions, each such digital asset issuer, among other things, was required to register its issued digital assets as a class of securities under Section 12(g) of the Exchange Act. In the case of Gladius Network, the relevant SEC cease-and-desist order required that Gladius Network:

> "Maintain such 1934 Act Registration and make timely filings of all reports required by Section 13(a) of the Securities Exchange Act of 1934 at least until the later of (1) the Claims Form Deadline; (2) such time as Respondent has filed all reports required for the fiscal year within which the 1934 Act Registration became effective; and (3) such time as Respondent is eligible to terminate its registration pursuant to Rule 12g-4 under the Securities Exchange Act of 1934."[17]

In each of Airfox, Paragon and Gladius, we note that the SEC determined that the digital assets in question constituted securities because they fell within the definition of investment contract.

While we express no view regarding whether the relevant digital assets in such cases were also "equity securities", we note that the SEC provided no explanation for treating those digital assets as equity securities. We believe that it would be appropriate for the SEC to clarify the circumstances under which an investment contract should be treated as an equity security for purposes of Section 12(g). In any event, we note that, if such digital assets

501(a)), determined as of such day rather than at the time of the sale of the securities; or in the case of a bank…." https://www.sec.gov/info/smallbus/secg/jobs-act-section-12g-small-business-compliance-guide.htm.

[15] Section 17A of the Exchange Act.

[16] See related letter to the SEC, available at https://www.sec.gov/Archives/edgar/data/1719379/000110465919020748/a18-15736_1ex1a15addexhbd6.htm.

[17] https://www.sec.gov/litigation/admin/2019/33-10608.pdf.

later transitioned such that they were no longer equity securities, then, presumably, such issuers would be permitted to terminate such registration in accordance with the terms of Section 12g-4.[18] We express no view as to whether a future determination that any such digital asset was not an equity security would permit immediate termination of registration but note that, under such circumstances it would appear that Section 12(g) would no longer apply.

(11) **The terms of the digital asset sale described in the No-Action Letter were very different from the forms of digital asset sales popular from 2016 to mid-2018.** While the Division's release of the No-Action Letter is notable, it does not change our view that the Staff is likely to view nearly every initial sale of a digital asset, particularly those conducted for fundraising purposes and for which a secondary market exists, as the sale of a security. Indeed, some have questioned why TurnKey decided to use a blockchain-based digital asset in its business at all, or why TurnKey sought to obtain no-action relief in the first place. Others have suggested that the original model proposed by TurnKey may have differed significantly from the proposal described in the final version of the incoming letter.

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Greg Strong, Partner - *DLx Law*
Joel Telpner, Partner - *Sullivan & Worcester LLP*

Support:

Olta Andoni, Esq., Attorney- *Ziliak Law LLC.*
Max Dilendorf, Partner - *Dilendorf Khurdayan*
Steven Ehrlich, Chief Operating Officer - *Wall Street Blockchain Alliance*

[18] "Revised Rule 12g-4(a) provides that termination of registration under Section 12(g) shall take effect in 90 days, or such shorter period as the Commission determines, after the issuer certifies on Form 15 that the class of securities is held of record by fewer than 300 persons, 1,200 persons in the case of a bank, a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act, or a bank holding company, as defined in Section 2 of the Bank Holding Company Act of 1956, or 500 persons where the total assets of the issuer have not exceeded $10 million on the last day of each of the preceding three years. [….]"https://www.sec.gov/rules/final/2016/33-10075.pdf; see also https://www.sec.gov/info/smallbus/secg/jobs-act-section-12g-small-business-compliance-guide.htm.

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Jason Gottlieb, Partner - *Morrison Cohen LLP*
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Greg Murphy, Co-Founder - *Evoke Capital Corporation*
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