Framework for "Investment Contract" Analysis of Digital Assets[1]

I. Introduction

If you are considering an Initial Coin Offering, sometimes referred to as an "ICO," or otherwise engaging in the offer, sale, or distribution of a digital asset,[2] you need to consider whether the U.S. federal securities laws apply. A threshold issue is whether the digital asset is a "security" under those laws.[3] The term "security" includes an "investment contract," as well as other instruments such as stocks, bonds, and transferable shares. A digital asset should be analyzed to determine whether it has the characteristics of any product that meets the definition of "security" under the federal securities laws. In this guidance, we provide a framework for analyzing whether a digital asset has the characteristics of one particular type of security – an "investment contract."[4] Both the Commission and the federal courts frequently use the "investment contract" analysis to determine whether unique or novel instruments or arrangements, such as digital assets, are securities subject to the federal securities laws.

The U.S. Supreme Court's *Howey* case and subsequent case law have found that an "investment contract" exists when there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others.[5] The so-called "*Howey* test" applies to any contract, scheme, or transaction, regardless of whether it has any of the characteristics of typical securities.[6] The focus of the *Howey* analysis is not only on the form and terms of the instrument itself (in this case, the digital asset) but also on the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold (which includes secondary market sales). Therefore, issuers and other persons and entities engaged in the marketing, offer, sale, resale, or distribution of any digital asset will need to analyze the relevant transactions to determine if the federal securities laws apply.

The federal securities laws require all offers and sales of securities, including those involving a digital asset, to either be registered under its provisions or to qualify for an exemption from registration. The registration provisions require persons to disclose certain information to investors, and that information must be complete and not materially misleading. This requirement for disclosure furthers the federal securities laws' goal of providing investors with the information necessary to make informed investment decisions. Among the information

that must be disclosed is information relating to the essential managerial efforts that affect the success of the enterprise.[7] This is true in the case of a corporation, for example, but also may be true for other types of enterprises regardless of their organizational structure or form.[8] Absent the disclosures required by law about those efforts and the progress and prospects of the enterprise, significant informational asymmetries may exist between the management and promoters of the enterprise on the one hand, and investors and prospective investors on the other hand. The reduction of these information asymmetries through required disclosures protects investors and is one of the primary purposes of the federal securities laws.

II. Application of *Howey* to Digital Assets

In this guidance, we provide a framework for analyzing whether a digital asset is an investment contract and whether offers and sales of a digital asset are securities transactions. As noted above, under the *Howey* test, an "investment contract" exists when there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others. Whether a particular digital asset at the time of its offer or sale satisfies the *Howey* test depends on the specific facts and circumstances. We address each of the elements of the *Howey* test below.

A. The Investment of Money

The first prong of the *Howey* test is typically satisfied in an offer and sale of a digital asset because the digital asset is purchased or otherwise acquired in exchange for value, whether in the form of real (or fiat) currency, another digital asset, or other type of consideration.[9]

B. Common Enterprise

Courts generally have analyzed a "common enterprise" as a distinct element of an investment contract.[10] In evaluating digital assets, we have found that a "common enterprise" typically exists.[11]

C. Reasonable Expectation of Profits Derived from Efforts of Others

Usually, the main issue in analyzing a digital asset under the *Howey* test is whether a purchaser has a reasonable expectation of profits (or other financial returns) derived from the efforts of others. A purchaser may expect to realize a return through participating in

distributions or through other methods of realizing appreciation on the asset, such as selling at a gain in a secondary market. When a promoter, sponsor, or other third party (or affiliated group of third parties) (each, an "Active Participant" or "AP") provides essential managerial efforts that affect the success of the enterprise, and investors reasonably expect to derive profit from those efforts, then this prong of the test is met. Relevant to this inquiry is the "economic reality"[12] of the transaction and "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect."[13] The inquiry, therefore, is an objective one, focused on the transaction itself and the manner in which the digital asset is offered and sold.

The following characteristics are especially relevant in an analysis of whether the third prong of the *Howey* test is satisfied.

1. Reliance on the Efforts of Others

The inquiry into whether a purchaser is relying on the efforts of others focuses on two key issues:

- Does the purchaser reasonably expect to rely on the efforts of an AP?
- Are those efforts "the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise,"[14] as opposed to efforts that are more ministerial in nature?

Although no one of the following characteristics is necessarily determinative, the stronger their presence, the more likely it is that a purchaser of a digital asset is relying on the "efforts of others":

- An AP is responsible for the development, improvement (or enhancement), operation, or promotion of the network,[15] particularly if purchasers of the digital asset expect an AP to be performing or overseeing tasks that are necessary for the network or digital asset to achieve or retain its intended purpose or functionality.[16]
    - Where the network or the digital asset is still in development and the network or digital asset is not fully functional at the time of the offer or sale, purchasers

would reasonably expect an AP to further develop the functionality of the network or digital asset (directly or indirectly). This particularly would be the case where an AP promises further developmental efforts in order for the digital asset to attain or grow in value.

- There are essential tasks or responsibilities performed and expected to be performed by an AP, rather than an unaffiliated, dispersed community of network users (commonly known as a "decentralized" network).
- An AP creates or supports a market for,[17] or the price of, the digital asset. This can include, for example, an AP that: (1) controls the creation and issuance of the digital asset; or (2) takes other actions to support a market price of the digital asset, such as by limiting supply or ensuring scarcity, through, for example, buybacks, "burning," or other activities.
- An AP has a lead or central role in the direction of the ongoing development of the network or the digital asset. In particular, an AP plays a lead or central role in deciding governance issues, code updates, or how third parties participate in the validation of transactions that occur with respect to the digital asset.
- An AP has a continuing managerial role in making decisions about or exercising judgment concerning the network or the characteristics or rights the digital asset represents including, for example:
    - Determining whether and how to compensate persons providing services to the network or to the entity or entities charged with oversight of the network.
    - Determining whether and where the digital asset will trade. For example, purchasers may reasonably rely on an AP for liquidity, such as where the AP has arranged, or promised to arrange for, the trading of the digital asset on a secondary market or platform.
    - Determining who will receive additional digital assets and under what conditions.
    - Making or contributing to managerial level business decisions, such as how to deploy funds raised from sales of the digital asset.

- Playing a leading role in the validation or confirmation of transactions on the network, or in some other way having responsibility for the ongoing security of the network.
- Making other managerial judgements or decisions that will directly or indirectly impact the success of the network or the value of the digital asset generally.

- Purchasers would reasonably expect the AP to undertake efforts to promote its own interests and enhance the value of the network or digital asset, such as where:
  - The AP has the ability to realize capital appreciation from the value of the digital asset. This can be demonstrated, for example, if the AP retains a stake or interest in the digital asset. In these instances, purchasers would reasonably expect the AP to undertake efforts to promote its own interests and enhance the value of the network or digital asset.
  - The AP distributes the digital asset as compensation to management or the AP's compensation is tied to the price of the digital asset in the secondary market. To the extent these facts are present, the compensated individuals can be expected to take steps to build the value of the digital asset.
  - The AP owns or controls ownership of intellectual property rights of the network or digital asset, directly or indirectly.
  - The AP monetizes the value of the digital asset, especially where the digital asset has limited functionality.

In evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the "efforts of others," including but not limited to:

- Whether or not the efforts of an AP, including any successor AP, continue to be important to the value of an investment in the digital asset.
- Whether the network on which the digital asset is to function operates in such a manner that purchasers would no longer reasonably expect an AP to carry out essential managerial or entrepreneurial efforts.
- Whether the efforts of an AP are no longer affecting the enterprise's success.

2. Reasonable Expectation of Profits

An evaluation of the digital asset should also consider whether there is a reasonable expectation of profits. Profits can be, among other things, capital appreciation resulting from the development of the initial investment or business enterprise or a participation in earnings resulting from the use of purchasers' funds.[18] Price appreciation resulting ***solely*** from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered "profit" under the *Howey* test.

The more the following characteristics are present, the more likely it is that there is a reasonable expectation of profit:

- The digital asset gives the holder rights to share in the enterprise's income or profits or to realize gain from capital appreciation of the digital asset.
    - The opportunity may result from appreciation in the value of the digital asset that comes, at least in part, from the operation, promotion, improvement, or other positive developments in the network, particularly if there is a secondary trading market that enables digital asset holders to resell their digital assets and realize gains.
    - This also can be the case where the digital asset gives the holder rights to dividends or distributions.
- The digital asset is transferable or traded on or through a secondary market or platform, or is expected to be in the future.[19]
- Purchasers reasonably would expect that an AP's efforts will result in capital appreciation of the digital asset and therefore be able to earn a return on their purchase.
- The digital asset is offered broadly to potential purchasers as compared to being targeted to expected users of the goods or services or those who have a need for the functionality of the network.

- The digital asset is offered and purchased in quantities indicative of investment intent instead of quantities indicative of a user of the network. For example, it is offered and purchased in quantities significantly greater than any likely user would reasonably need, or so small as to make actual use of the asset in the network impractical.

- There is little apparent correlation between the purchase/offering price of the digital asset and the market price of the particular goods or services that can be acquired in exchange for the digital asset.
- There is little apparent correlation between quantities the digital asset typically trades in (or the amounts that purchasers typically purchase) and the amount of the underlying goods or services a typical consumer would purchase for use or consumption.
- The AP has raised an amount of funds in excess of what may be needed to establish a functional network or digital asset.
- The AP is able to benefit from its efforts as a result of holding the same class of digital assets as those being distributed to the public.
- The AP continues to expend funds from proceeds or operations to enhance the functionality or value of the network or digital asset.
- The digital asset is marketed, directly or indirectly, using any of the following:
  - The expertise of an AP or its ability to build or grow the value of the network or digital asset.
  - The digital asset is marketed in terms that indicate it is an investment or that the solicited holders are investors.
  - The intended use of the proceeds from the sale of the digital asset is to develop the network or digital asset.
  - The future (and not present) functionality of the network or digital asset, and the prospect that an AP will deliver that functionality.

- The promise (implied or explicit) to build a business or operation as opposed to delivering currently available goods or services for use on an existing network.
- The ready transferability of the digital asset is a key selling feature.
- The potential profitability of the operations of the network, or the potential appreciation in the value of the digital asset, is emphasized in marketing or other promotional materials.
- The availability of a market for the trading of the digital asset, particularly where the AP implicitly or explicitly promises to create or otherwise support a trading market for the digital asset.

In evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the "reasonable expectation of profits," including but not limited to:

- Purchasers of the digital asset no longer reasonably expect that continued development efforts of an AP will be a key factor for determining the value of the digital asset.
- The value of the digital asset has shown a direct and stable correlation to the value of the good or service for which it may be exchanged or redeemed.
- The trading volume for the digital asset corresponds to the level of demand for the good or service for which it may be exchanged or redeemed.
- Whether holders are then able to use the digital asset for its intended functionality, such as to acquire goods and services on or through the network or platform.
- Whether any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
- No AP has access to material, non-public information or could otherwise be deemed to hold material inside information about the digital asset.

3. Other Relevant Considerations

When assessing whether there is a reasonable expectation of profit derived from the efforts of others, federal courts look to the economic reality of the transaction.[20] In doing so, the courts also have considered whether the instrument is offered and sold for use or consumption by purchasers.[21]

Although no one of the following characteristics of use or consumption is necessarily determinative, the stronger their presence, the less likely the *Howey* test is met:

- The distributed ledger network and digital asset are fully developed and operational.
- Holders of the digital asset are immediately able to use it for its intended functionality on the network, particularly where there are built-in incentives to encourage such use.
- The digital assets' creation and structure is designed and implemented to meet the needs of its users, rather than to feed speculation as to its value or development of its network. For example, the digital asset can only be used on the network and generally can be held or transferred only in amounts that correspond to a purchaser's expected use.
- Prospects for appreciation in the value of the digital asset are limited. For example, the design of the digital asset provides that its value will remain constant or even degrade over time, and, therefore, a reasonable purchaser would not be expected to hold the digital asset for extended periods as an investment.
- With respect to a digital asset referred to as a virtual currency, it can immediately be used to make payments in a wide variety of contexts, or acts as a substitute for real (or fiat) currency.
    - This means that it is possible to pay for goods or services with the digital asset without first having to convert it to another digital asset or real currency.
    - If it is characterized as a virtual currency, the digital asset actually operates as a store of value that can be saved, retrieved, and exchanged for something of value at a later time.

- With respect to a digital asset that represents rights to a good or service, it currently can be redeemed within a developed network or platform to acquire or otherwise use those goods or services. Relevant factors may include:
    - There is a correlation between the purchase price of the digital asset and a market price of the particular good or service for which it may be redeemed or exchanged.
    - The digital asset is available in increments that correlate with a consumptive intent versus an investment or speculative purpose.
    - An intent to consume the digital asset may also be more evident if the good or service underlying the digital asset can only be acquired, or more efficiently acquired, through the use of the digital asset on the network.
- Any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
- The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset.
- Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.
- Restrictions on the transferability of the digital asset are consistent with the asset's use and not facilitating a speculative market.
- If the AP facilitates the creation of a secondary market, transfers of the digital asset may only be made by and among users of the platform.

Digital assets with these types of use or consumption characteristics are less likely to be investment contracts. For example, take the case of an online retailer with a fully-developed operating business. The retailer creates a digital asset to be used by consumers to purchase products only on the retailer's network, offers the digital asset for sale in exchange for real currency, and the digital asset is redeemable for products commensurately priced in that real currency. The retailer continues to market its products to its existing customer base, advertises

its digital asset payment method as part of those efforts, and may "reward" customers with digital assets based on product purchases. Upon receipt of the digital asset, consumers immediately are able to purchase products on the network using the digital asset. The digital assets are not transferable; rather, consumers can only use them to purchase products from the retailer or sell them back to the retailer at a discount to the original purchase price. Under these facts, the digital asset would not be an investment contract.

Even in cases where a digital asset can be used to purchase goods or services on a network, where that network's or digital asset's functionality is being developed or improved, there may be securities transactions if, among other factors, the following is present: the digital asset is offered or sold to purchasers at a discount to the value of the goods or services; the digital asset is offered or sold to purchasers in quantities that exceed reasonable use; and/or there are limited or no restrictions on reselling those digital assets, particularly where an AP is continuing in its efforts to increase the value of the digital assets or has facilitated a secondary market.

III. Conclusion

The discussion above identifies some of the factors market participants should consider in assessing whether a digital asset is offered or sold as an investment contract and, therefore, is a security. It also identifies some of the factors to be considered in determining whether and when a digital asset may no longer be a security. These factors are not intended to be exhaustive in evaluating whether a digital asset is an investment contract or any other type of security, and no single factor is determinative; rather, we are providing them to assist those engaging in the offer, sale, or distribution of a digital asset, and their counsel, as they consider these issues. We encourage market participants to seek the advice of securities counsel and engage with the Staff through www.sec.gov/finhub.

[1] This framework represents the views of the Strategic Hub for Innovation and Financial Technology ("FinHub," the "Staff," or "we") of the Securities and Exchange Commission (the "Commission"). It is not a rule, regulation, or statement of the Commission, and the Commission has neither approved nor disapproved its content. Further, this 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. *See, e.g., Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (Exchange Act Rel. No. 81207) (July 25, 2017) ("*The DAO Report*"); William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), available at https://www.sec.gov/news/speech/speech-hinman-061418.

[2] The term "digital asset," as used in this framework, refers to an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called "virtual currencies," "coins," and "tokens."

[3] The term "security" is defined in Section 2(a)(1) of the Securities Act of 1933 (the "Securities Act"), Section 3(a)(10) of the Securities Exchange Act of 1934, Section 2(a)(36) of the Investment Company Act of 1940, and Section 202(a)(18) of the Investment Advisers Act of 1940.

[4] This framework is intended to be instructive and is based on the Staff's experiences to date and relevant law and legal precedent. It is not an exhaustive treatment of the legal and regulatory issues relevant to conducting an analysis of whether a product is a security, including an investment contract analysis with respect to digital assets generally. We expect that analysis concerning digital assets as securities may evolve over time as the digital asset market matures. Also, no one factor is necessarily dispositive as to whether or not an investment contract exists.

[5] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) ("*Howey*"). *See also United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) ("*Forman*"); *Tcherepnin v. Knight*, 389 U.S. 332 (1967) ("*Tcherepnin*"); *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) ("*Joiner*").

[6] Whether a contract, scheme, or transaction is an investment contract is a matter of federal, not state, law and does not turn on whether there is a formal contract between parties. Rather, under the *Howey* test, "form [is] disregarded for substance and the emphasis [is] on economic reality." *Howey*, 328 U.S. at 298. The Supreme Court has further explained that that the term security "embodies a flexible rather than a static principle" in order to meet the "variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.* at 299.

[7] Issuers of digital assets, like all issuers, must provide full and fair disclosure of material information consistent with the requirements of the federal securities laws. Issuers of digital assets should be guided by the regulatory framework and concepts of materiality. What is material depends upon the nature and structure of the issuer's particular network and circumstances. *See TSC Industries v. Northway*, 426 U.S. 438, 449 (1976) (a fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision or if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" to the shareholder).

[8] *See The DAO Report*.

[9] The lack of monetary consideration for digital assets, such as those distributed via a so-called "bounty program" does not mean that the investment of money prong is not satisfied. As the Commission explained in *The DAO Report*, "[i]n determining whether an investment contract exists, the investment of 'money' need not take the form of cash" and "in spite of *Howey's* reference to an 'investment of money,' it is well established that cash is not the only form of contribution or investment that will create an investment contract." *The DAO Report* at 11 (citation omitted). *See In re Tomahawk Exploration LLC*, Securities Act Rel. 10530 (Aug. 14, 2018) (issuance of tokens under a so-called "bounty program" constituted an offer and sale of securities because the issuer provided tokens to investors in exchange for services designed to advance the issuer's economic interests and foster a trading market for its securities). Further, the lack of monetary consideration for digital assets, such as those distributed via a so-called "air drop," does not mean that the investment of money prong is not satisfied; therefore, an airdrop may constitute a sale or distribution of securities. In a so-called "airdrop," a digital asset is distributed to holders of another digital asset, typically to promote its circulation.

[10] In order to satisfy the "common enterprise" aspect of the *Howey* test, federal courts require that there be either "horizontal commonality" or "vertical commonality." *See Revak v. SEC Realty Corp*., 18 F.3d. 81, 87-88 (2d Cir. 1994) (discussing horizontal commonality as "the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits" and two variants of vertical commonality, which focus "on the relationship between the promoter and the body of investors"). The Commission, on the other hand, does not require vertical or horizontal commonality *per se*, nor does it view a "common enterprise" as a distinct element of the term "investment contract." *In re Barkate*, 57 S.E.C. 488, 496 n.13 (Apr. 8, 2004); *see also* the Commission's Supplemental Brief at 14 in *SEC v. Edwards*, 540 U.S. 389 (2004) (on remand to the 11th Circuit).

[11] Based on our experiences to date, investments in digital assets have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter's efforts. *See SEC v. Int'l Loan Network, Inc.*, 968 F.2d 1304, 1307 (D.C. Cir. 1992).

[12] *Howey*, 328 U.S. at 298. *See also Tcherepnin*, 389 U.S. at 336 ("in searching for the meaning and scope of the word 'security' in the [Acts], form should be disregarded for substance and the emphasis should be on economic reality.")

[13] *Joiner*, 320 U.S. at 352-53.

[14] *SEC v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821, 94 S. Ct. 117, 38 L. Ed. 2d 53 (1973) ("*Turner*").

[15] In this guidance, we are using the term "network" broadly to encompass the various elements that comprise a digital asset's network, enterprise, platform, or application.

[16] We recognize that holders of digital assets may put forth some effort in the operations of the network, but those efforts do not negate the fact that the holders of digital assets are relying on the efforts of the AP. That a scheme assigns "nominal or limited responsibilities to the [investor] does not negate the existence of an investment contract." *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 n.15 (5th Cir. 1974) (citation and quotation marks omitted). If the AP provides efforts that are "the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise," and the AP is not merely performing ministerial or routine tasks, then there likely is an investment contract. *See Turner*, 474 U.S. at 482; *see also The DAO Report* (although DAO token holders had certain voting rights, they nonetheless reasonably relied on the managerial efforts of others). Managerial and entrepreneurial efforts typically are characterized as involving expertise and decision-making that impacts the success of the business or enterprise through the application of skill and judgment.

[17] *See, e.g., Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce Fenner & Smith*, 756 F.2d 230 (2d Cir. 1985).

[18] *See Forman*, 421 U.S. at 852.

[19] Situations where the digital asset is exchangeable or redeemable solely for goods or services within the network or on a platform, and may not otherwise be transferred or sold, may more likely be a payment for a good or service in which the purchaser is motivated to use or consume the digital asset. *See* discussion of "Other Relevant Considerations."

[20] As noted above, under *Howey*, courts conduct an objective inquiry focused on the transaction itself and the manner in which it is offered.

[21] *See Forman*, 421 U.S. at 852-53 (where a purchaser is not "'attracted solely by the prospects of a return' on his investment . . . [but] is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply.").

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THE SEC RELEASES NEW "FRAMEWORK" TO ANALYZE DIGITAL ASSETS UNDER SECURITIES LAWS

On April 3, 2019, the Securities and Exchange Commission ("SEC") released the **"Framework for 'Investment Contract' Analysis of Digital Assets"** (the "Framework"). The Framework—published by the SEC's Strategic Hub for Innovation and Financial Technology ("FinHub") —is the most comprehensive guidance the SEC has provided to date with respect to a method of analyzing whether digital assets fall within existing securities laws. Although the Framework is not a binding rule, regulation or statement of the SEC, it provides much needed guidance to the public on analyzing whether a particular token is likely to be considered a security. The Framework builds on the SEC's previous analysis, as articulated in The DAO Investigative Report, **[1]** the *Munchee* settlement **[2]** and other enforcement actions and informal statements by the Commission **[3]**.

The Framework

Consistent with the SEC's prior guidance, the Framework outlines the applicable standard for analyzing digital assets under the securities laws by applying the "investment contract" test articulated in *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293 (1946) to digital assets. The Framework presents the SEC's view that the first two prongs of the *Howey* test—whether there is: (1) an investment of money; and (2) a common enterprise —as typically satisfied in the case of digital assets. As a result, much of the SEC's analysis turns on application of the third prong, namely whether there is a reasonable expectation of profits to be derived from the efforts of others. The SEC breaks this prong into two components: (i) whether purchasers are reliant on the managerial efforts of others; and (ii) whether purchasers are led to expect profits from such efforts.

The Framework articulates an illustrative list of factors that may suggest that purchasers are relying on the managerial efforts of others, including whether there is an expectation that other parties—including sponsors, promoters or other third-parties—perform the following activities for the benefit of the digital asset or network:

- Develops or maintains the functionality of the network;
- Attains growth in the value of the digital asset;
- Take steps to support a market price by limiting supply or forcing scarcity, for example, through buybacks or "burning;" and/or
- Exercises continuing managerial oversight of the digital asset or network, including (i) making decisions about compensating individuals for work related to the asset or network; (ii) determining whether a digital asset will be traded on a secondary market or platform; (iv) establishing criteria for distributing additional digital assets to individuals; (v) making business decisions about using the proceeds of a digital asset sale; (vi) playing an integral role in validating transactions; (vii) overseeing network security; and (viii) otherwise making decisions that will impact the success of

the digital asset or network, in addition to other factors.

The Framework also outlines factors that may suggest that a purchaser has a reasonable expectation of profits, including where:

- Purchasers share in the capital appreciation of the digital asset;
- The digital asset can be traded on the secondary market;
- The digital asset is sold to purchasers who are not likely to use the asset for anything other than investment purposes;
- The digital asset is marketed or promoted as an investment;
- Proceeds from the sale of the digital asset are used to increase the value of the digital asset or functionality of the network; and/or
- The digital asset bears little correlation to the value of goods or services the digital asset can be exchanged for.

The Framework also includes a list of factors that may suggest that an instrument is not a security. These factors largely focus on the ability to use a digital asset for consumer or commercial purposes, and not primarily as an investment. For example, the following factors may indicate that a digital asset is less likely to be considered a security:

- The network or platform is fully developed and operational;
- The digital asset was designed for use rather than investment;
- The potential for appreciation of the digital asset is limited;
- Trading or transfer of the digital asset is restricted;
- The digital asset can be used as a payment tool for goods or services; and/or
- Any appreciation in value of the asset is incidental to its intended use.

The Framework also notes that partial functionality, or an expectation that either a network will grow substantially or digital assets will appreciate in value, may lead to the conclusion that even a functional token is actually a security.

Implications of The Framework for Issuers and Purchasers of Digital Assets

While the Framework clarifies guidance previously articulated by the SEC through enforcement actions and comments of Commissioners, the Framework does not radically alter the analytic approach as to whether digital assets are securities. The Framework is helpful, however, in distilling the relevant factors that have been articulated in a variety of sources into one operative document. Further, the Framework is instructive as it implicitly endorses the notion that a digital security that was once deemed a security may no longer be a security after the asset achieves certain developmental milestones, such as achieving its intended functionality, including use as a medium of exchange, without requiring ongoing efforts of others. The Framework also articulates several additional factors that may indicate that, “at the time of later offers or sales,” an instrument may no longer be a security.

Going forward, insights from the Framework will be helpful to issuers and their advisors as they (1) seek to prospectively structure their platforms and digital assets in a manner that will not implicate the securities laws; or (2) seek to evaluate whether existing digital assets have become sufficiently decentralized such that they may no longer be considered securities. The Framework is also significant for exchanges, alternative trading systems and other platforms that support trading or exchange of digital assets, which can benefit from integrating this guidance into their existing rubrics for evaluating whether

digital assets that are traded on their platforms may implicate the securities laws.

Where these comments are non-binding, issuers and exchanges should not assume that their adherence to the factors articulated in the Framework will necessarily be dispositive in the securities analysis in an individual case. The Framework does, however, provide yet another helpful touchpoint in the mix of information available as the industry attempts to structure securities-compliant blockchain platforms and digital assets.

[1] *See, e.g., Report of Investigation Pursuant to Section 21(a) of the Securities and Exchange Act of 1934: The DAO* (Exchange Act Rel. No. 81207) (July 25, 2017) ("*The DAO Investigative Report*").

[2] *In re Munchee Inc*., Securities Act Release No. 10445 (December 11, 2017).

[3] *See, e.g.,* William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), available at https://www.sec.gov/news/speech/speech-hinman-061418.

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,

- against -

MAKSIM ZASLAVSKIY,

Defendant.

17-CR-0647 (RJD)

BRIEF OF SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF THE UNITED STATES IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS INDICTMENT

SECURITIES AND EXCHANGE COMMISSION
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PRELIMINARY STATEMENT

The United States Department of Justice ("Government") and the Securities and Exchange Commission ("SEC" or "Commission") each have filed actions against Defendant Maksim Zaslavskiy ("Zaslavskiy" or "Defendant") for fraud in connection with his offer and sale of investments in two schemes, in which he promised investors high profits in real estate investments and later in diamonds. Defendant sought to take advantage of investor exuberance around so-called Initial Coin Offerings ("ICOs"), using this terminology to peddle the investments. But, as the Government and the SEC allege, Defendant simply engaged in old-fashioned fraud dressed in a new-fashioned label.

Defendant seeks now, in his motion to dismiss, to re-cast the investments at issue here as "currency" sales, exempt from the securities laws. However, it is the substance of the transaction—not the terminology used—that determines the character of the offering. The federal securities laws have anti-fraud and other provisions that are principles-based, broad and flexible, and are aimed at protecting investors from fraud, as well as registration provisions that mandate disclosure of critical information to investors. These provisions provide the SEC with important tools that can be applied to securities activities involving novel technologies—regardless of how they are used. See SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946) (definition of "security" embodies a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.") (emphasis added).

The offerings here were securities under long-standing and clear precedent. The SEC has a keen interest in ensuring that the federal securities laws are applied to all manner of securities offerings to provide the important market and investor protections.

PROCEDURAL BACKGROUND

A grand jury sitting in this District has charged Defendant with conspiracy and substantive securities fraud counts, in contravention of Sections 10(b) and 32 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78j(b) and 78ff. The charges arise out of Zaslavskiy's alleged fraud in connection with general solicitations for investments in REcoin Group Foundation, LLC ("REcoin") in the form of a so-called "Initial Coin Offering" ("ICO") for interests in REcoin (the "REcoin Token"), and in Diamond Reserve Club ("Diamond" or "Diamond Tokens," together with REcoin Tokens the "Tokens").

The SEC has similarly charged Zaslavskiy, REcoin, and Diamond with violations of Section 10(b) of the Exchange Act, as well as violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), id. §§ 77e(a), 77e(c) and 77q(a), based largely on the same underlying conduct. See Complaint, SEC v. REcoin Grp. Found., LLC, et al., No. 17 Civ. 5725 (RJD) (E.D.N.Y. Sept. 29, 2017).

Zaslavskiy has moved to dismiss the Government's charges on the basis that: (1) the Tokens are not "securities" within the meaning of Section 2(a)(1) of the Securities Act, 15 U.S.C. § 77b(a)(1), and Section 3(a)(10) of the Exchange Act, id. § 78c(a)(1); (2) the Tokens are "currencies" exempted from the securities laws; and (3) Sections 10(b) and 32 of the Exchange Act are unconstitutionally vague as applied to "cryptocurrencies." On February 2, 2018, the SEC sought, and was later granted, leave to file a brief in support of the Government and in opposition to Defendant's motion to dismiss. See Letter at 1 (Feb. 2, 2018) (D.E. 18).

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

I. SEC's Mission

The SEC is the primary regulator of the U.S. securities markets. Its mission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. Critical to

the SEC's effectiveness in promoting fair disclosures and preventing fraud in the offer and sale of securities is the ability to enforce violations of the securities laws through civil actions.

Congress enacted the federal securities laws and created the Commission after the stock market crash of 1929, when half of the new securities sold during the post-World War I period turned out to be worthless. See Joel Seligman, The Transformation of Wall Street 1—2 (3d ed. 2003). The securities laws embrace a "fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1466 (2d Cir. 1996) (quoting Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972)). The SEC obviously has a keen interest in the interpretation and application of the securities laws and, in particular, the definitional provisions of the Securities and Exchange Acts and how they apply to all manner of instruments, such as those at issue in this case.

Issuers and individuals increasingly have been using distributed ledger (or blockchain) technology in connection with raising capital for businesses and projects. A blockchain is a peer-to-peer database spread across a network that uses cryptography to record all transactions in the network in theoretically unchangeable, digitally-stored data packages called blocks, linked together in a chain. ICOs are blockchain-enabled offerings often targeted at retail investors—in the U.S. and globally. ICOs promise profits through the issuance of digital assets (often called coins, tokens, or cryptocurrencies) in exchange for fiat currency or other digital assets (often Bitcoins). The overall size of the ICO market has grown exponentially. It is reported that $3 billion has been raised so far in 2018; over $5 billion in 2017; and nearly $300 million in 2016. See generally www.coindesk.com/ico-tracker (last visited Mar. 19, 2018). These numbers may understate the size of the ICO market (and the potential for investor loss) as many ICOs

"trade up" for some period after they are issued. Much of this form of fund-raising appears to be unlawfully conducted through unregistered and/or fraudulent offerings of securities.

II. SEC Enforcement Actions Involving ICOs

In July 2017, the SEC issued a Report of Investigation pursuant to Section 21(a) of the Exchange Act, 15 U.S.C. § 78u(a), regarding an ICO for so-called "DAO Tokens." See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Release No. 81207, 2017 WL 7184670 (July 25, 2017) (the "Report") (Exhibit A hereto). In the Report, the SEC considered the particular facts and circumstances presented by the offer and sale of DAO Tokens and concluded that they were securities based on long-standing legal principles, and that offers and sales of DAO Tokens were thus subject to the federal securities laws. The Report explained that issuers of distributed ledger or blockchain technology-based securities must register offers and sales of such securities unless a valid exemption from registration applies. The automation of certain functions through "smart contracts" or computer code or other technology, the Report concluded, does not remove conduct from the purview of the federal securities laws. Thus, the SEC's message to issuers and others in this space has been clear: the use of distributed ledger or blockchain technology to raise capital or engage in securities transactions does not alter the need to comply with the federal securities laws.

The SEC has been actively enforcing the federal securities laws in the ICO space. In addition to the parallel action the SEC has filed against Defendant and his entities, the SEC has brought a number of enforcement actions concerning ICOs for alleged violations of the federal securities laws. See SEC v. AriseBank, et al., No. 18 Civ. 186 (BML) (N.D. Tex. Jan. 30, 2018) (emergency action to halt allegedly fraudulent and unregistered ICO); SEC v. PlexCorps, et al., No. 17 Civ. 7007 (CBA) (E.D.N.Y. Dec. 1, 2017) (same); In re Matter of Munchee Inc.,

Exchange Act Release No. 10445, 2017 WL 6374434 (Dec. 11, 2017) ("Munchee") (settled administrative proceeding against unregistered ICO).

The SEC has also issued more than a dozen trading suspensions to halt trading in the stock of publicly-traded issuers who have made spurious claims relating to blockchain technology. See Investor Alert: Public Companies Making ICO-Related Claims (Aug. 28, 2017), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_icorelatedclaims (warning investors about potential market manipulation schemes involving publicly traded companies that claim ICO-related news) (Exhibit B); SEC Suspends Trading in Three Issuers Claiming Involvement in Cryptocurrency and Blockchain Technology (Feb. 16, 2018), https://www.sec.gov/news/press-release/2018-20 (SEC announces trading suspensions in issuers claiming involvement in cryptocurrency and blockchain technology) (Exhibit C); https://www.sec.gov/litigation/suspensions.shtml (listing all SEC trading suspensions) (last visited Mar. 19, 2018).

III. Investor Protection Concerns Involving ICOs

The SEC's Chairman has publicly expressed concerns regarding the ICO markets, including that, as they are currently operating, there is substantially less investor protection than in our traditional securities markets, with correspondingly greater opportunities for fraud and manipulation. See SEC Chairman Jay Clayton, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 (Exhibit D). The ability of bad actors to commit age-old frauds using new technologies, coupled with the significant amounts of capital pouring into the ICO market—particularly from retail investors—has only heightened these concerns.

Commission staff has noted specific risks to investors due to the fact that ICOs are promoted online and involve the issuance and distribution of a digital asset on a blockchain. See

Investor Bulletin: Initial Coin Offerings (July 25, 2017), https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings (warning investors to the risks of ICOs) (Exhibit E); Investor Alert: Bitcoin and Other Virtual Cryptocurrency-Related Investments (May 7, 2014), https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-bitcoin-other-virtual-currency (warning investors to the risks of Bitcoin and other virtual currency-related investments) (Exhibit F). Commission staff also has noted that digital assets may be trading on secondary markets over unlawful online platforms that may offer few investor protections. Statement on Potentially Unlawful Online Platforms for Trading Digital Assets (Mar. 7, 2018), https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading (Exhibit G).

Several characteristics of how ICOs are conducted pose challenges for law enforcement in investigating fraud. For example, (1) tracing funds: traditional financial institutions (such as banks) often are not involved, making it harder to follow the flow of funds; (2) international scope: blockchain transactions and users span the globe and there may be restrictions on how the SEC can obtain and use information from foreign jurisdictions; (3) no central authority: as there is no central authority that collects blockchain user information, the SEC generally must rely on other sources, such as digital asset exchanges, for this type of information; (4) seizing or freezing digital assets: digital "wallets" (software that "stores" digital assets) may be encrypted and, unlike money held in a bank or brokerage account, may not be held by a third-party custodian; (5) anonymity: many digital assets are specifically designed to be pseudonymous or anonymous; thus, attribution of a specific digital asset to an individual or entity could be difficult or impossible, especially where additional anonymizing tools are employed; and (6) evolving technology: digital assets involve new and developing technologies.

Overall, the SEC's investor concerns in this area have been communicated through numerous public statements, investor alerts and bulletins, press releases, and filed enforcement actions. Those communications and actions have been highlighted on the SEC's www.investor.gov website on a page entitled, "Spotlight on Initial Coin Offerings and Digital Assets." See https://www.investor.gov/additional-resources/specialized-resources/spotlight-initial-coin-offerings-digital-assets (last visited Mar. 19, 2018).

IV. Continuing Efforts to Protect Investors

The SEC is acutely focused on unlawful conduct in this area. In 2017, the SEC formed a Cyber Unit within its Division of Enforcement, to address cyber-related misconduct, including involving distributed ledger technology and ICOs. The SEC is continuing to police the digital asset and ICO markets vigorously and to bring enforcement actions against those who conduct ICOs or other actions relating to digital assets in violation of the federal securities laws.

The SEC's ability to fulfill its mission and protect investors and the markets is critically dependent on the appropriate application of the federal securities laws to all types of instruments—including the Tokens at issue in this case. An improper application of the definitional provisions of the Securities and Exchange Acts or an unduly narrow reading of established precedent as applied to the Tokens here could severely hinder the SEC's efforts.

FACTUAL BACKGROUND

The Government's Memorandum in Opposition to Defendant's Motion (the "Government's Brief") comprehensively sets forth the facts relevant to the resolution of this motion. The SEC briefly sets forth here certain facts alleged in the Indictment, which must be taken as true. United States v. Scully, 108 F. Supp. 3d 59, 117 (E.D.N.Y. 2015).

Defendant Zaslavskiy conducted ICOs for interests in REcoin in July of 2017 and, later, in Diamond. Indictment ¶¶ 1-3, 10. Defendant launched a website for the REcoin ICO where he

identified himself as the founder and CEO, spoke of other team members associated with the enterprise, and permitted investors to purchase REcoin Tokens using fiat currency or digital assets. Id. ¶ 12. Defendant advertised the REcoin ICO as "an attractive investment opportunity" that "grows in value," touted the "experienced team" of professionals that led the enterprise, and explained that REcoin "invests" the proceeds from the REcoin ICO "into global real estate[,] based on the soundest strategies." Id. ¶ 14; see also id. ¶ 11 (Defendant explained that the REcoin ICO funds would be used to buy real estate and investors could look forward to "some of the highest potential returns"). Although Defendant touted the availability of digital asset technologies to protect an investor's purchase, such as a "REcoin Purse" that was "secured by the latest cryptocurrency tools," id. ¶ 14, in reality no digital token or asset existed and none had been developed. Id. ¶ 16. Defendant made other misrepresentations in connection with the REcoin ICO, including regarding the amount of funds raised and the existence of a team of professionals. Id. ¶¶ 13, 16. More than 1,000 individuals invested in the REcoin ICO. Id. ¶ 17.

Defendant's scheme with respect to the Diamond Tokens was substantially identical. At some point in September 2017, Defendant began advertising Diamond Tokens by offering REcoin Token purchasers the opportunity to convert their investments into Diamond Tokens, by explaining that Diamond would use the proceeds of the Diamond ICO to invest in diamonds, and by forecasting a "minimum growth of 10% to 15% per year" for the investments. Id. ¶¶ 18-19, 22. As he did with respect to REcoin, Defendant detailed the growth efforts he was engaged in with respect to Diamond, including developing the Diamond "ecosystem" and identifying diamonds and their storage locations. Id. ¶¶ 20, 23. Defendant also touted efforts to list the Diamond Tokens on exchanges to increase profits, and otherwise made many of the same misstatements with respect to the Diamond ICO as he did with respect to REcoin. Id. ¶¶ 22-23.

ARGUMENT

The Government's Brief persuasively demonstrates that the Tokens are securities and that Defendant's motion should be denied. The SEC agrees in full with the arguments in the Government's Brief—which are consistent with the SEC's long-standing legal precedent—and here highlights only certain points germane to rebut Defendant's arguments.

I. Legal Background

A. The Registration and Anti-Fraud Provisions of the Securities Laws

The Securities Act, 15 U.S.C. §§ 77a, et seq., contains registration provisions that contemplate that the offer or sale of "securities" to the public must be accompanied by the "full and fair disclosure" afforded by registration with the SEC and delivery of a statutory prospectus containing information necessary to enable potential purchasers to make an informed investment decision.[1] See, e.g., SEC v. Cavanagh, 1 F. Supp. 2d 337, 360 (S.D.N.Y. 1998), aff'd, 155 F.3d 129 (2d Cir. 1998); SEC v. Aaron, 605 F.2d 612, 618 (2d Cir. 1979) (citing SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953)), vacated on other grounds, 446 U.S. 680 (1980).

Section 5(a) of the Securities Act provides that, unless a registration statement is in effect as to a security or an exemption for registration applies, it is unlawful for any person, directly or indirectly, to engage in the offer or sale of securities in interstate commerce. Section 5(c) of the Securities Act provides a similar prohibition against offers to sell, or offers to buy, unless a registration statement has been filed or an exemption from registration applies. Thus, both Sections 5(a) and 5(c) of the Securities Act prohibit the unregistered offer or sale of "securities" in interstate commerce absent an exemption. 15 U.S.C. §§ 77e(a), (c).

[1] Although not specifically at issue in this criminal action, Sections 5 and 17(a) of the Securities Act are at issue in the parallel civil case filed by the SEC. See Complaint ¶¶ 10, 94, 97, 100, SEC v. REcoin, et al., No. 17 Civ. 5725 (RJD) (D.E. 1) (Sept. 29, 2017).

The Exchange Act, 15 U.S.C. §§ 78a, et seq., prohibits using or employing "in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b) (emphasis added). The Securities Act, 15 U.S.C. §§ 77a, et seq., similarly prohibits "in the offer or sale of any securities . . . to employ any device, scheme, or artifice to defraud, or . . . to obtain money or property by means of any untrue statement of a material fact . . . ." Id. § 77q(a).

The applicability of the foregoing provisions and the outcome of the criminal and civil actions before this Court therefore turn on the meaning of the word "securities" as it is used in the Securities and Exchange Acts.

B. "Investment Contracts" Are "Securities"

Under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, a security includes "an investment contract." See id. §§ 77b(a), 78c(a). As the Government's Brief notes, the Supreme Court's decision in Howey holds that an "investment contract" is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. See 328 U.S. at 301; see also SEC v. Edwards, 540 U.S. 389, 393 (2004). Howey "permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of the many types of instruments" offered in "our commercial world." 328 U.S. at 299. Howey states the test for both the criminal and civil enforcement of the securities laws. See, e.g., United States v. Leonard, 529 F.3d 83, 87-91 (2d Cir. 2008). As the Supreme Court has recognized, Congress crafted "a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment." Reves v. Ernst & Young, 494 U.S. 56, 60-61 (1990).

C. The SEC's Application of Howey in the DAO Report

In the Report, the Commission concluded that "DAO Tokens" were investment contracts under Howey because, among other factors: (1) investors in DAO Tokens purchased them using the digital asset known as Ether, which constituted an "investment of 'money,'" Report, 2017 WL 7184670, *8 (citation omitted); (2) investors had a reasonable expectation of profits because DAO promoters informed investors that the DAO was a for-profit entity "whose objective was to fund projects in exchange for a return on investment," id. at *9; and (3) investors expected that their profits would be derived from the entrepreneurial and managerial efforts of others given that the promoters laid out their own vision and plans for the company in promotional materials, spoke about how they would select persons to work on the projects "based on their expertise and credentials," and touted their expertise in blockchain technologies, whereas the limited voting rights and wide dispersion of investors "did not provide [investors] with meaningful control over the enterprise." Id. at *9-11; see also Munchee, 2017 WL 6374434, *4 (settled order).

II. The Tokens Here Are Investment Contracts and Therefore Securities

The charges in the Indictment make clear that the Tokens easily satisfy each prong of Howey: they constitute an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial and managerial efforts of others.

A. Token Purchasers Invested Money

Individuals invested in REcoin and Diamond "through its website using their credit cards, virtual currency or through online funds transfer services." Indictment ¶¶ 12, 20. Such investment is the type of contribution of value that can create an investment contract under Howey. See SEC v. Shavers, No. 13 Civ. 416 (ALM), 2014 WL 4652121, *1 (E.D. Tex. Sept. 18, 2014) (holding that an investment of Bitcoin meets the first prong of Howey).

Defendant's insistence that people who chose to buy a Token were "simply exchanging one medium of currency for another," Def. Br. at 12, essentially concedes that the first prong of Howey is satisfied. The first prong of Howey contemplates that the "'investment' may take the form of 'goods and services,' or some other 'exchange of value.'" Uselton v. Com. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991) (citation omitted) (emphasis added). Accordingly, an investment occurred here regardless of how Defendant now seeks to relabel it.

B. In a Common Enterprise[2]

Defendant told investors in the REcoin Tokens that their assets would be pooled and invested into real estate selected by Defendant and his "experienced team" so that "people from all over the world'" could share in "real estate investments 'with some of the highest potential returns." Indictment ¶¶ 11, 14. After offering a "conversion of REcoin Tokens into Diamond [T]okens," id. ¶ 19, Defendant made similar representations with respect to the Diamond Tokens, namely, that investor funds would be used to purchase diamonds selected by Defendant and his "experienced team," and that the company "forecast a minimum growth of 10% to 15% per year." Id. ¶¶ 14, 21, 22. The second prong of Howey is therefore met because the "fortunes of each investor depend upon the profitability of the enterprise as a whole" and there was a "tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of

[2] The Commission does not require commonality per se or view a "common enterprise" as a distinct element of the term "investment contract." In its opinion in In re Barkate, the Commission stated that a "common enterprise" is not a distinct requirement for an "investment contract" under Howey. Release No. 49542, 82 SEC Docket 2130, 2004 WL 762434, *3 n.13 (Apr. 8, 2004), aff'd sub nom. Barkate v. SEC, 125 F. App'x 892 (9th Cir. 2005). The Second Circuit has stated that a showing of "horizontal commonality" can establish a common enterprise. See generally Revak v. SEC Realty Corp., 18 F.3d 81, 87-88 (2d Cir. 1994). Broadly defined, horizontal commonality is the pooling of investor assets in the common enterprise, such that the fortunes of investors are tied to each other, whereas vertical commonality focuses on the relationship between the promoter and the investor. In any event, as explained further herein, the Indictment shows the existence of commonality in this case.

assets, usually combined with the pro-rata distribution of profits." Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994); see also infra p. 18-19 (discussing pro-rata distribution of profits).[3]

Defendant's contrary argument, that there is no commonality because each individual can dispose of a Token on his or her own, is misguided. The second prong of Howey focuses on whether an individual's fortunes with respect to the investment are tied together to others', as they were undisputedly linked here. An individual's ability to exchange or dispose of an investment contract on his or her own—which exists with respect to many forms of investments that are straight-forward examples of investment contracts (see, e.g., Edwards, 540 U.S. at 391-92 (purchaser of payphone lease investment contract had option to sell back lease to promoter))—is not germane to and does not alter this analysis.

C. With a Reasonable Expectation of Profits

The various promotional materials disseminated by Defendant informed investors that REcoin and Diamond were for-profit entities such that the value of the investments would be expected to increase based on the profitability of the business. Specifically, as the REcoin whitepaper stated, the supposed REcoin Token was "an attractive investment opportunity" because it would "grow[] in value." Indictment ¶ 14. Similarly, the Diamond Token was forecasted for a "minimum growth of 10% to 15% per year" and Defendant informed investors that he was looking to list the Diamond Token "on external exchanges [to] make more profit." Id. ¶ 22. Accordingly, investors in the Tokens had a reasonable expectation of an increase in the

[3] The investments here also satisfy the strict vertical commonality test because investors' fortunes in the Tokens were tied to Defendant's profits. See Revak, 18 F.3d at 87 (in the absence of horizontal commonality, strict vertical commonality may also be sufficient). Defendant claimed that he would earn a "commission" when the Token holders used or sold their Tokens. See Def. Br. at Ex. A (REcoin whitepaper) (D.E. 22-50); id. at Ex. B (Diamond whitepaper) (D.E. 22-58).

value of their purchase, a type of profit specifically recognized as satisfying Howey. Edwards, 540 U.S. at 394 (explaining that expected profits can include "dividends, other periodic payments, or the increased value of the investment.") (emphasis added).

D. Derived from the Managerial Efforts of Others

Defendant represented that the REcoin investment would grow in value based on his managerial efforts both in selecting the assets that would back the investments and in developing the supposed environment in which the Tokens could be used. Defendant stated that "REcoin is led by an experienced team of brokers, lawyers, and developers and invests its proceeds into global real estate based on the soundest strategies." Indictment ¶ 14. He also stated that the value of the Diamond Tokens would grow based on his development of the Diamond "ecosystem." Id. ¶¶ 19-21. Defendant likewise explained that his success of his efforts to list Diamond Tokens on exchanges was among the sources of the investors' returns. Id. ¶¶ 22. This suffices to meet Howey's last prong, in which the essential inquiry is "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir. 1973); see also Cont'l Mktg., Corp. v. SEC, 387 F.2d 466, 470-71 (10th Cir. 1967) (promoters' efforts to "develop" a "structure into which investors entered" was part of efforts to increase the value of the investment).

Seeking to minimize the central role Defendant held himself out as playing in these ventures, Defendant argues that "adoptors [sic] with shared professional interests would work together to create an ecosystem" that would lead to an increase in the venture's value. Def. Br. at 15. However, Defendant cannot minimize the importance of the supposed investment expertise of him and his team. Given Defendant's statement that "people from all over the world" were free to purchase the Tokens, Indictment ¶ 11, the investors in these Tokens "could

not reasonably be believed to be desirous or capable of undertaking" these projects "on their own," and thus had to rely on the Defendant's managerial expertise. SEC v. Aqua–Sonic Prods. Corp., 687 F.2d 577, 583-84 (2d Cir. 1982); see also Leonard, 529 F.3d at 88 (investors need not literally rely "solely" on the efforts of others). Even if an investor's efforts help to make an enterprise profitable, those efforts do not negate a promoter's significant managerial efforts. See, e.g., Glenn W. Turner, 474 F.2d at 482 (finding that a multi-level marketing scheme was an investment contract and that investors relied on the promoter's managerial efforts, despite the fact that investors put forth the majority of the labor that made the enterprise profitable, because the promoter dictated the terms and controlled the scheme).

III. Defendant's Contrary Arguments Are Unavailing

Defendant does not squarely address most of the foregoing factual contentions or their interaction with Howey. Rather, Defendant argues that: (1) the Tokens were "to be" or were "intended to be" "currency" as that term is used in the Exchange Act, and therefore exempt from the securities laws; (2) because there was no pro-rata distribution of profits, there was no commonality; and (3) because the REcoin investors (but not the Diamond investors) were offered voting rights, whatever profit would not be derived from the managerial effort of others. Defendant's arguments mischaracterize the facts and misstate the law.

A. Defendant's Attempt to Label the Investments Here as "Cryptocurrencies" Does Not Change Their Character as Securities

Defendant dubs the investments at issue here "cryptocurrencies" or "virtual currencies" and urges the Court to issue a broad ruling that such assets—as a class—are statutorily exempt from the definition of securities under the Securities and Exchange Acts. Def. Br. at 6-10. Defendant argues that "cryptocurrencies" or "virtual currencies" are "currency" within the

meaning of the Exchange Act, 15 U.S.C. § 78c(a)(10), and are therefore exempt from the definition of "security," simply because he now has decided to call them "cryptocurrencies."[4]

First, the appropriate focus is on the economics of the offering, not its label. See, e.g., United Hous. Found., Inc v. Forman, 421 U.S. 837, 849 (1975). What Defendant promised purchasers at the time of the offer and sale were returns on an investment. But, even if Defendant is to be believed that his intent at the time was eventually to issue tokens to be used as "cryptocurrencies" in a blockchain-based ecosystem, building such an ecosystem would have required Defendant's efforts before any cryptocurrency could be issued by it or used within it. See Indictment ¶¶ 11, 14, 16, 20, 22-23. Defendant's supposed plan that the Tokens would, one day, be useful in that ecosystem that he had not built does not alter the nature of Defendant's promise to investors. Defendant offered and sold the investment opportunity to profit from his development of that ecosystem. Defendant's fund-raising effort to obtain capital—even assuming an intention to build that ecosystem—bears all the hallmarks of a securities offering.

Second, Defendant's effort to evade the application of the securities laws by labeling the Tokens "cryptocurrencies" should be rejected as contrary to the broad and principles-based analysis that decades of law dictate. The economic realities demonstrate that the investments offered and sold are securities, as detailed above. See, e.g., Forman, 421 U.S. at 849 ("Congress intended the application of these [securities] statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto."); see also SEC Chairman Jay Clayton and CFTC Chairman Christopher Giancarlo, Regulators are Looking at Cryptocurrency, Wall Street Journal (Jan. 24, 2018) ("[S]ome products that are labeled cryptocurrencies have characteristics

[4] The definition of "security" under the Exchange Act expressly excludes "currency." 15 U.S.C. § 78c(a)(10) (Section 3(a)(10) of the Exchange Act). The Securities Act's definition of "security" does not exclude "currency" (see id. § 77b(a)(1)), but courts have treated the two definitions as the same. See Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985).

that make them securities. The offer, sale and trading of such products must be carried out in compliance with securities law. The SEC will vigorously pursue those who seek to evade the registration, disclosure and antifraud requirements of our securities laws."). Indeed, one is hard-pressed to imagine what would be left of the securities laws if simply labelling an investment contract a "currency" could make it so. See, e.g., Long v. Shultz Cattle Co., 881 F.2d 129, 136 (5th Cir. 1989) (examining "the economic realities of [the promoter]'s program" and rejecting the promoter's attempts to "avoid the securities laws by simply attaching the label 'consulting agreement' to a package of services which [was] clearly . . . an investment contract").

Defendant advances a number of strawman arguments concerning digital assets unlike those at issue here. For example, Defendant relies on United States v. Ulbricht, 31 F. Supp. 3d 540, 569-70 (S.D.N.Y. 2014), where the district court determined that Bitcoin is a type of "fund" or "monetary instrument" under a money laundering statute, 18 U.S.C. § 1956(c)(4). But Bitcoin is a completely different asset than the investment at issue here. Defendant's Tokens were not even created at the time of the offer and sale, and could not be used to buy anything. Thus, the Ulbricht court's decision that Bitcoin is a "fund" or "monetary instrument" says nothing about whether the Tokens Defendant offered and sold are securities.

Finally, because the question whether an investment constitutes a "security" within the meaning of the Securities and Exchange Acts is highly fact-specific, the Court need not resolve broader questions about whether all (or which) digital assets are within the purview of the Acts. Nor must the Court broadly decide whether an entire category of "cryptocurrency" is a "currency" for purposes of the exclusion set forth in Section 3(a)(10) of the Exchange Act.[5]

[5] The Treasury Department's Financial Crimes Enforcement Network has noted: "In contrast to real currency, 'virtual' currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency

When one looks past labels, as the Supreme Court has instructed, what was offered in this case was plainly not a currency of any nature.

B. A Pro-Rata Distribution of Profits is Not Required and, in Any Event, Is Present Here

Defendant is also incorrect to suggest that horizontal commonality requires a pro-rata distribution of profit. See Def. Br. at 13. The Second Circuit has explained that horizontal commonality requires "pooling of assets," which is "usually" combined with such distribution—but not that such a distribution is necessary. Revak, 18 F.3d at 87.

Other courts that have applied horizontal commonality recognize that it is sufficient that "each investor was entitled to receive returns directly proportionate to his or her investment stake," "either for direct distribution or as an increase in the value of the investment." SEC v. SG Ltd., 265 F.3d 42, 46-47, 51 (1st Cir. 2001) (finding horizontal commonality); accord SEC v. Infinity Grp. Co., 212 F.3d 180, 188 (3d Cir. 2000) (finding horizontal commonality where the "return on investment was to be apportioned according to the amounts committed by the investor" and was "directly proportional to the amount of that investment").

Here, investors would have reasonably expected profits (from real estate, diamonds, and/or tokens) that were directly proportional to their investment, as well as a pro rata distribution of profits. The REcoin whitepaper states that the profits from the REcoin enterprise

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does not have legal tender status in any jurisdiction." Guidance: Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (Mar. 18, 2013) (discussing 31 C.F.R. § 1010.100(m)), available at https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering (last visited Mar. 19, 2018). The CFTC has concluded that Bitcoin is a virtual currency that is a commodity, "distinct from 'real' currencies, which are the coin and paper money of the United States or another country that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance." In re Coinflip, Inc., CFTC No. 15-29, 2015 WL 5535736, *1 n.2 (Sept. 17, 2015). The IRS has concluded that "virtual currency is not treated as currency" for purposes of federal tax laws. IRS Virtual Currency Guidance, I.R.S. Notice 2014-21, 2014-16 I.R.B. 938, 2014 WL 1224474 (Apr. 14, 2014).

would be reinvested into that enterprise—an allegation that Defendant acknowledges in his papers and does not dispute. See Def. Br. at 13 n.5 & 32 (REcoin whitepaper). That reinvestment of profits is nothing more than a pro-rata distribution in kind to the investors in the enterprise (in other words, a proportionate return "as an increase in the value of the investment," SG Ltd., 265 F.3d at 47), such that the commonality prong is satisfied.

C. The "Voting Rights" Offered to REcoin Investors Were Illusory

Defendant argues that because the REcoin Tokens gave investors voting rights, investors retained control of the enterprise such that the last Howey prong is not met. See Def. Br. at 17. Here, however, these voting rights were illusory both because there is no detail in the offering materials about how the voting process would work, see id. at 27-51 (REcoin whitepaper), and because, given the large number of REcoin investors (more than 1,000, see Indictment ¶ 17), their ability to exercise any real control would be minimal. See Williamson v. Tucker, 645 F.2d 404, 423 (5th Cir. 1981) ("[O]ne would not expect partnership interests sold to large numbers of the general public to provide any real partnership control; at some point there would be so many [limited] partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level or a single shareholder in a corporation."); see also SEC v. Merch. Capital, LLC, 483 F.3d 747, 754-66 (11th Cir. 2007) (finding an investment contract even where voting rights were provided to purported general partners, noting that the voting process provided limited information for investors to make informed decisions, and the purported general partners lacked control over the information in the ballots). And, of course, many types of securities come with voting rights, such as common shares in a public company.[6]

[6] The SEC agrees with the Government's treatment of Defendant's vagueness argument. To the extent Defendant argues that the term "investment contract" is void for vagueness, the Second Circuit has rejected that argument. See SEC v. Brigadoon Scotch Distrib. Co., 480 F.2d 1047,

CONCLUSION

In its role as the primary regulator of the national securities markets, the SEC has a paramount interest in the application of the federal securities laws to capital raises—whatever the terminology or technology used. The investments Defendant offered and sold fall squarely within the ambit of the federal securities laws. For the foregoing reasons, as well as those advanced in the Government's Brief, Defendant's motion should be denied.

Dated: March 19, 2018
New York, N.Y.

SECURITIES AND EXCHANGE COMMISSION

By: _____

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1052 n.6 (2d Cir. 1973) ("In light of the many Supreme Court decisions defining and applying the term we find such a position untenable."); accord Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027, 1029 (2d Cir. 1974) (following Brigadoon Scotch). Moreover, the SEC has communicated its interests in regulating ICOs in numerous public statements. See supra pp. 4-7; see also CFTC v. McDonnell, No. 18 Civ. 361 (JBW), 2018 WL 1175156, *5, *7, *12 (E.D.N.Y. Mar. 6, 2018) (noting the SEC's regulation of digital assets as "securities").

Exhibit A

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 81207 / July 25, 2017

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO

I. Introduction and Summary

The United States Securities and Exchange Commission's ("Commission") Division of Enforcement ("Division") has investigated whether The DAO, an unincorporated organization; Slock.it UG ("Slock.it"), a German corporation; Slock.it's co-founders; and intermediaries may have violated the federal securities laws. The Commission has determined not to pursue an enforcement action in this matter based on the conduct and activities known to the Commission at this time.

As described more fully below, The DAO is one example of a Decentralized Autonomous Organization, which is a term used to describe a "virtual" organization embodied in computer code and executed on a distributed ledger or blockchain. The DAO was created by Slock.it and Slock.it's co-founders, with the objective of operating as a for-profit entity that would create and hold a corpus of assets through the sale of DAO Tokens to investors, which assets would then be used to fund "projects." The holders of DAO Tokens stood to share in the anticipated earnings from these projects as a return on their investment in DAO Tokens. In addition, DAO Token holders could monetize their investments in DAO Tokens by re-selling DAO Tokens on a number of web-based platforms ("Platforms") that supported secondary trading in the DAO Tokens.

After DAO Tokens were sold, but before The DAO was able to commence funding projects, an attacker used a flaw in The DAO's code to steal approximately one-third of The DAO's assets. Slock.it's co-founders and others responded by creating a work-around whereby DAO Token holders could opt to have their investment returned to them, as described in more detail below.

The investigation raised questions regarding the application of the U.S. federal securities laws to the offer and sale of DAO Tokens, including the threshold question whether DAO Tokens are securities. Based on the investigation, and under the facts presented, the Commission has determined that DAO Tokens are securities under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[1] The Commission deems it appropriate and in the public interest to issue this report of investigation ("Report") pursuant to

[1] This Report does not analyze the question whether The DAO was an "investment company," as defined under Section 3(a) of the Investment Company Act of 1940 ("Investment Company Act"), in part, because The DAO never commenced its business operations funding projects. Those who would use virtual organizations should consider their obligations under the Investment Company Act.

Section 21(a) of the Exchange Act[2] to advise those who would use a Decentralized Autonomous Organization ("DAO Entity"), or other distributed ledger or blockchain-enabled means for capital raising, to take appropriate steps to ensure compliance with the U.S. federal securities laws. All securities offered and sold in the United States must be registered with the Commission or must qualify for an exemption from the registration requirements. In addition, any entity or person engaging in the activities of an exchange must register as a national securities exchange or operate pursuant to an exemption from such registration.

This Report reiterates these fundamental principles of the U.S. federal securities laws and describes their applicability to a new paradigm—virtual organizations or capital raising entities that use distributed ledger or blockchain technology to facilitate capital raising and/or investment and the related offer and sale of securities. The automation of certain functions through this technology, "smart contracts,"[3] or computer code, does not remove conduct from the purview of the U.S. federal securities laws.[4] This Report also serves to stress the obligation to comply with the registration provisions of the federal securities laws with respect to products and platforms involving emerging technologies and new investor interfaces.

II. Facts

A. Background

From April 30, 2016 through May 28, 2016, The DAO offered and sold approximately 1.15 billion DAO Tokens in exchange for a total of approximately 12 million Ether ("ETH"), a

[2] Section 21(a) of the Exchange Act authorizes the Commission to investigate violations of the federal securities laws and, in its discretion, to "publish information concerning any such violations." This Report does not constitute an adjudication of any fact or issue addressed herein, nor does it make any findings of violations by any individual or entity. The facts discussed in Section II, *infra*, are matters of public record or based on documentary records. We are publishing this Report on the Commission's website to ensure that all market participants have concurrent and equal access to the information contained herein.

[3] Computer scientist Nick Szabo described a "smart contract" as:

> a computerized transaction protocol that executes terms of a contract. The general objectives of smart contract design are to satisfy common contractual conditions (such as payment terms, liens, confidentiality, and even enforcement), minimize exceptions both malicious and accidental, and minimize the need for trusted intermediaries. Related economic goals include lowering fraud loss, arbitrations and enforcement costs, and other transaction costs.

See Nick Szabo, *Smart Contracts*, 1994, http://www.virtualschool.edu/mon/Economics/SmartContracts.html.

[4] *See SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943) ("[T]he reach of the [Securities] Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a 'security'."); *see also Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990) ("Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.").

virtual currency[5] used on the Ethereum Blockchain.[6] As of the time the offering closed, the total ETH raised by The DAO was valued in U.S. Dollars ("USD") at approximately $150 million.

The concept of a DAO Entity is memorialized in a document (the "White Paper"), authored by Christoph Jentzsch, the Chief Technology Officer of Slock.it, a "Blockchain and IoT [(internet-of-things)] solution company," incorporated in Germany and co-founded by Christoph Jentzsch, Simon Jentzsch (Christoph Jentzsch's brother), and Stephan Tual ("Tual").[7] The White Paper purports to describe "the first implementation of a [DAO Entity] code to automate organizational governance and decision making."[8] The White Paper posits that a DAO Entity "can be used by individuals working together collaboratively outside of a traditional corporate form. It can also be used by a registered corporate entity to automate formal governance rules contained in corporate bylaws or imposed by law." The White Paper proposes an entity—a DAO Entity—that would use smart contracts to attempt to solve governance issues it described as inherent in traditional corporations.[9] As described, a DAO Entity purportedly would supplant traditional mechanisms of corporate governance and management with a blockchain such that contractual terms are "formalized, automated and enforced using software."[10]

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[5] The Financial Action Task Force defines "virtual currency" 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.

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.

[6] Ethereum, developed by the Ethereum Foundation, a Swiss nonprofit organization, is a decentralized platform that runs smart contracts on a blockchain known as the Ethereum Blockchain.

[7] Christoph Jentzsch released the final draft of the White Paper on or around March 23, 2016. He introduced his concept of a DAO Entity as early as November 2015 at an Ethereum Developer Conference in London, as a medium to raise funds for Slock.it, a German start-up he co-founded in September 2015. Slock.it purports to create technology that embeds smart contracts that run on the Ethereum Blockchain into real-world devices and, as a result, for example, permits anyone to rent, sell or share physical objects in a decentralized way. *See* SLOCK.IT, https://slock.it/.

[8] Christoph Jentzsch, *Decentralized Autonomous Organization to Automate Governance Final Draft – Under Review*, https://download.slock.it/public/DAO/WhitePaper.pdf.

[9] *Id.*

[10] *Id.* The White Paper contained the following statement:

> A word of caution, at the outset: the legal status of [DAO Entities] remains the subject of active and vigorous debate and discussion. Not everyone shares the same definition. Some have said that [DAO Entities] are autonomous code and can operate independently of legal systems; others

B. The DAO

"The DAO" is the "first generation" implementation of the White Paper concept of a DAO Entity, and it began as an effort to create a "crowdfunding contract" to raise "funds to grow [a] company in the crypto space."[11] In November 2015, at an Ethereum Developer Conference in London, Christoph Jentzsch described his proposal for The DAO as a "for-profit DAO [Entity]," where participants would send ETH (a virtual currency) to The DAO to purchase DAO Tokens, which would permit the participant to vote and entitle the participant to "rewards."[12] Christoph Jentzsch likened this to "buying shares in a company and getting … dividends."[13] The DAO was to be "decentralized" in that it would allow for voting by investors holding DAO Tokens.[14] All funds raised were to be held at an Ethereum Blockchain "address" associated with The DAO and DAO Token holders were to vote on contract proposals, including proposals to The DAO to fund projects and distribute The DAO's anticipated earnings from the projects it funded.[15] The DAO was intended to be "autonomous" in that project proposals were in the form of smart contracts that exist on the Ethereum Blockchain and the votes were administered by the code of The DAO.[16]

> have said that [DAO Entities] must be owned or operate[d] by humans or human created entities. There will be many use cases, and the DAO [Entity] code will develop over time. Ultimately, how a DAO [Entity] functions and its legal status will depend on many factors, including how DAO [Entity] code is used, where it is used, and who uses it. This paper does not speculate about the legal status of [DAO Entities] worldwide. This paper is not intended to offer legal advice or conclusions. Anyone who uses DAO [Entity] code will do so at their own risk.

Id.

[11] Christoph Jentzsch, *The History of the DAO and Lessons Learned*, SLOCK.IT BLOG (Aug. 24, 2016), https://blog.slock.it/the-history-of-the-dao-and-lessons-learned-d06740f8cfa5#.5o62zo8uv. Although The DAO has been described as a "crowdfunding contract," The DAO would not have met the requirements of Regulation Crowdfunding, adopted under Title III of the Jumpstart Our Business Startups (JOBS) Act of 2012 (providing an exemption from registration for certain crowdfunding), because, among other things, it was not a broker-dealer or a funding portal registered with the SEC and the Financial Industry Regulatory Authority ("FINRA"). *See Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, SEC (Apr. 5, 2017), https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm; *Updated Investor Bulletin: Crowdfunding for Investors*, SEC (May 10, 2017), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding-.html.

[12] *See* Slockit, *Slock.it DAO demo at Devcon1: IoT + Blockchain*, YOUTUBE (Nov. 13, 2015), https://www.youtube.com/watch?v=49wHQoJxYPo.

[13] *Id.*

[14] *See* Jentzsch, *supra* note 8.

[15] *Id.* In theory, there was no limitation on the type of project that could be proposed. For example, proposed "projects" could include, among other things, projects that would culminate in the creation of products or services that DAO Token holders could use or charge others for using.

[16] *Id.*

On or about April 29, 2016, Slock.it deployed The DAO code on the Ethereum Blockchain, as a set of pre-programmed instructions.[17] This code was to govern how The DAO was to operate.

To promote The DAO, Slock.it's co-founders launched a website ("The DAO Website"). The DAO Website included a description of The DAO's intended purpose: "To blaze a new path in business for the betterment of its members, existing simultaneously nowhere and everywhere and operating solely with the steadfast iron will of unstoppable code."[18] The DAO Website also described how The DAO operated, and included a link through which DAO Tokens could be purchased. The DAO Website also included a link to the White Paper, which provided detailed information about a DAO Entity's structure and its source code and, together with The DAO Website, served as the primary source of promotional materials for The DAO. On The DAO Website and elsewhere, Slock.it represented that The DAO's source code had been reviewed by "one of the world's leading security audit companies" and "no stone was left unturned during those five whole days of security analysis."[19]

Slock.it's co-founders also promoted The DAO by soliciting media attention and by posting almost daily updates on The DAO's status on The DAO and Slock.it websites and numerous online forums relating to blockchain technology. Slock.it's co-founders used these posts to communicate to the public information about how to participate in The DAO, including: how to create and acquire DAO Tokens; the framework for submitting proposals for projects; and how to vote on proposals. Slock.it also created an online forum on The DAO Website, as well as administered "The DAO Slack" channel, an online messaging platform in which over 5,000 invited "team members" could discuss and exchange ideas about The DAO in real time.

1. DAO Tokens

In exchange for ETH, The DAO created DAO Tokens (proportional to the amount of ETH paid) that were then assigned to the Ethereum Blockchain address of the person or entity remitting the ETH. A DAO Token granted the DAO Token holder certain voting and ownership rights. According to promotional materials, The DAO would earn profits by funding projects

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[17] According to the White Paper, a DAO Entity is "activated by deployment on the Ethereum [B]lockchain. Once deployed, a [DAO Entity's] code requires 'ether' [ETH] to engage in transactions on Ethereum. Ether is the digital fuel that powers the Ethereum Network." The only way to update or alter The DAO's code is to submit a new proposal for voting and achieve a majority consensus on that proposal. *See* Jentzsch, *supra* note 8. According to Slock.it's website, Slock.it gave The DAO code to the Ethereum community, noting that:

> The DAO framework is [a] side project of Slock.it UG and a gift to the Ethereum community. It consisted of a definitive whitepaper, smart contract code audited by one of the best security companies in the world and soon, a complete frontend interface. All free and open source for anyone to re-use, it is our way to say 'thank you' to the community.

SLOCK.IT, https://slock.it. The DAO code is publicly-available on GitHub, a host of source code. *See The Standard DAO Framework, Inc., Whitepaper*, GITHUB, https://github.com/slockit/DAO.

[18] The DAO Website was available at https://daohub.org.

[19] Stephen Tual, *Deja Vu DAO Smart Contracts Audit Results*, SLOCK.IT BLOG (Apr. 5, 2016), https://blog.slock.it/deja-vu-dai-smart-contracts-audit-results-d26bc088e32e.

that would provide DAO Token holders a return on investment. The various promotional materials disseminated by Slock.it's co-founders touted that DAO Token holders would receive "rewards," which the White Paper defined as, "any [ETH] received by a DAO [Entity] generated from projects the DAO [Entity] funded." DAO Token holders would then vote to either use the rewards to fund new projects or to distribute the ETH to DAO Token holders.

From April 30, 2016 through May 28, 2016 (the "Offering Period"), The DAO offered and sold DAO Tokens. Investments in The DAO were made "pseudonymously" (i.e., an individual's or entity's pseudonym was their Ethereum Blockchain address). To purchase a DAO Token offered for sale by The DAO, an individual or entity sent ETH from their Ethereum Blockchain address to an Ethereum Blockchain address associated with The DAO. All of the ETH raised in the offering as well as any future profits earned by The DAO were to be pooled and held in The DAO's Ethereum Blockchain address. The token price fluctuated in a range of approximately 1 to 1.5 ETH per 100 DAO Tokens, depending on when the tokens were purchased during the Offering Period. Anyone was eligible to purchase DAO Tokens (as long as they paid ETH). There were no limitations placed on the number of DAO Tokens offered for sale, the number of purchasers of DAO Tokens, or the level of sophistication of such purchasers.

DAO Token holders were not restricted from re-selling DAO Tokens acquired in the offering, and DAO Token holders could sell their DAO Tokens in a variety of ways in the secondary market and thereby monetize their investment as discussed below. Prior to the Offering Period, Slock.it solicited at least one U.S. web-based platform to trade DAO Tokens on its system and, at the time of the offering, The DAO Website and other promotional materials disseminated by Slock.it included representations that DAO Tokens would be available for secondary market trading after the Offering Period via several platforms. During the Offering Period and afterwards, the Platforms posted notices on their own websites and on social media that each planned to support secondary market trading of DAO Tokens.[20]

In addition to secondary market trading on the Platforms, after the Offering Period, DAO Tokens were to be freely transferable on the Ethereum Blockchain. DAO Token holders would also be permitted to redeem their DAO Tokens for ETH through a complicated, multi-week (approximately 46-day) process referred to as a DAO Entity "split."[21]

2. Participants in The DAO

According to the White Paper, in order for a project to be considered for funding with "a DAO [Entity]'s [ETH]," a "Contractor" first must submit a proposal to the DAO Entity. Specifically, DAO Token holders expected Contractors to submit proposals for projects that could provide DAO Token holders returns on their investments. Submitting a proposal to The DAO involved: (1) writing a smart contract, and then deploying and publishing it on the

[20] The Platforms are registered with FinCEN as "Money Services Businesses" and provide systems whereby customers may exchange virtual currencies for other virtual currencies or fiat currencies.

[21] According to the White Paper, the primary purpose of a split is to protect minority shareholders and prevent what is commonly referred to as a "51% Attack," whereby an attacker holding 51% of a DAO Entity's Tokens could create a proposal to send all of the DAO Entity's funds to himself or herself.

Ethereum Blockchain; and (2) posting details about the proposal on The DAO Website, including the Ethereum Blockchain address of the deployed contract and a link to its source code. Proposals could be viewed on The DAO Website as well as other publicly-accessible websites. Per the White Paper, there were two prerequisites for submitting a proposal. An individual or entity must: (1) own at least one DAO Token; and (2) pay a deposit in the form of ETH that would be forfeited to the DAO Entity if the proposal was put up for a vote and failed to achieve a quorum of DAO Token holders. It was publicized that Slock.it would be the first to submit a proposal for funding.[22]

ETH raised by The DAO was to be distributed to a Contractor to fund a proposal only on a majority vote of DAO Token holders.[23] DAO Token holders were to cast votes, which would be weighted by the number of tokens they controlled, for or against the funding of a specific proposal. The voting process, however, was publicly criticized in that it could incentivize distorted voting behavior and, as a result, would not accurately reflect the consensus of the majority of DAO Token holders. Specifically, as noted in a May 27, 2016 blog post by a group of computer security researchers, The DAO's structure included a "strong positive bias to vote YES on proposals and to suppress NO votes as a side effect of the way in which it restricts users' range of options following the casting of a vote."[24]

Before any proposal was put to a vote by DAO Token holders, it was required to be reviewed by one or more of The DAO's "Curators." At the time of the formation of The DAO, the Curators were a group of individuals chosen by Slock.it.[25] According to the White Paper, the Curators of a DAO Entity had "considerable power." The Curators performed crucial security functions and maintained ultimate control over which proposals could be submitted to, voted on, and funded by The DAO. As stated on The DAO Website during the Offering Period, The DAO relied on its Curators for "failsafe protection" and for protecting The DAO from "malicous [sic] actors." Specifically, per The DAO Website, a Curator was responsible for: (1) confirming that any proposal for funding originated from an identifiable person or organization; and (2)

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[22] It was stated on The DAO Website and elsewhere that Slock.it anticipated that it would be the first to submit a proposal for funding. In fact, a draft of Slock.it's proposal for funding for an "Ethereum Computer and Universal Sharing Network" was publicly-available online during the Offering Period.

[23] DAO Token holders could vote on proposals, either by direct interaction with the Ethereum Blockchain or by using an application that interfaces with the Ethereum Blockchain. It was generally acknowledged that DAO Token holders needed some technical knowledge in order to submit a vote, and The DAO Website included a link to a step-by-step tutorial describing how to vote on proposals.

[24] By voting on a proposal, DAO Token holders would "tie up" their tokens until the end of the voting cycle. *See* Jentzsch, *supra* note 8 at 8 ("The tokens used to vote will be blocked, meaning they can not [sic] be transferred until the proposal is closed."). If, however, a DAO Token holder abstained from voting, the DAO Token holder could avoid these restrictions; any DAO Tokens not submitted for a vote could be withdrawn or transferred at any time. As a result, DAO Token holders were incentivized either to vote yes or to abstain from voting. *See* Dino Mark et al., *A Call for a Temporary Moratorium on The DAO*, HACKING, DISTRIBUTED (May 27, 2016, 1:35 PM), http://hackingdistributed.com/2016/05/27/dao-call-for-moratorium/.

[25] At the time of The DAO's launch, The DAO Website identified eleven "high profile" individuals as holders of The DAO's Curator "Multisig" (or "private key"). These individuals all appear to live outside of the United States. Many of them were associated with the Ethereum Foundation, and The DAO Website touted the qualifications and trustworthiness of these individuals.

confirming that smart contracts associated with any such proposal properly reflected the code the Contractor claims to have deployed on the Ethereum Blockchain. If a Curator determined that the proposal met these criteria, the Curator could add the proposal to the "whitelist," which was a list of Ethereum Blockchain addresses that could receive ETH from The DAO if the majority of DAO Token holders voted for the proposal.

Curators of The DAO had ultimate discretion as to whether or not to submit a proposal for voting by DAO Token holders. Curators also determined the order and frequency of proposals, and could impose subjective criteria for whether the proposal should be whitelisted. One member of the group chosen by Slock.it to serve collectively as the Curator stated publicly that the Curator had "complete control over the whitelist … the order in which things get whitelisted, the duration for which [proposals] get whitelisted, when things get unwhitelisted … [and] clear ability to control the order and frequency of proposals," noting that "curators have tremendous power."[26] Another Curator publicly announced his subjective criteria for determining whether to whitelist a proposal, which included his personal ethics.[27] Per the White Paper, a Curator also had the power to reduce the voting quorum requirement by 50% every other week. Absent action by a Curator, the quorum could be reduced by 50% only if no proposal had reached the required quorum for 52 weeks.

3. Secondary Market Trading on the Platforms

During the period from May 28, 2016 through early September 2016, the Platforms became the preferred vehicle for DAO Token holders to buy and sell DAO Tokens in the secondary market using virtual or fiat currencies. Specifically, the Platforms used electronic systems that allowed their respective customers to post orders for DAO Tokens on an anonymous basis. For example, customers of each Platform could buy or sell DAO Tokens by entering a market order on the Platform's system, which would then match with orders from other customers residing on the system. Each Platform's system would automatically execute these orders based on pre-programmed order interaction protocols established by the Platform.

None of the Platforms received orders for DAO Tokens from non-Platform customers or routed its respective customers' orders to any other trading destinations. The Platforms publicly displayed all their quotes, trades, and daily trading volume in DAO Tokens on their respective websites. During the period from May 28, 2016 through September 6, 2016, one such Platform executed more than 557,378 buy and sell transactions in DAO Tokens by more than 15,000 of its U.S. and foreign customers. During the period from May 28, 2016 through August 1, 2016, another such Platform executed more than 22,207 buy and sell transactions in DAO Tokens by more than 700 of its U.S. customers.

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[26] Epicenter, *EB134 – Emin Gün Sirer And Vlad Zamfir: On A Rocky DAO*, YOUTUBE (June 6, 2016), https://www.youtube.com/watch?v=ON5GhIQdFU8.

[27] Andrew Quentson, *Are the DAO Curators Masters or Janitors?*, THE COIN TELEGRAPH (June 12, 2016), https://cointelegraph.com/news/are-the-dao-curators-masters-or-janitors.

4. Security Concerns, The "Attack" on The DAO, and The Hard Fork

In late May 2016, just prior to the expiration of the Offering Period, concerns about the safety and security of The DAO's funds began to surface due to vulnerabilities in The DAO's code. On May 26, 2016, in response to these concerns, Slock.it submitted a "DAO Security Proposal" that called for the development of certain updates to The DAO's code and the appointment of a security expert.[28] Further, on June 3, 2016, Christoph Jentzsch, on behalf of Slock.it, proposed a moratorium on all proposals until alterations to The DAO's code to fix vulnerabilities in The DAO's code had been implemented.[29]

On June 17, 2016, an unknown individual or group (the "Attacker") began rapidly diverting ETH from The DAO, causing approximately 3.6 million ETH—1/3 of the total ETH raised by The DAO offering—to move from The DAO's Ethereum Blockchain address to an Ethereum Blockchain address controlled by the Attacker (the "Attack").[30] Although the diverted ETH was then held in an address controlled by the Attacker, the Attacker was prevented by The DAO's code from moving the ETH from that address for 27 days.[31]

In order to secure the diverted ETH and return it to DAO Token holders, Slock.it's co-founders and others endorsed a "Hard Fork" to the Ethereum Blockchain. The "Hard Fork," called for a change in the Ethereum protocol on a going forward basis that would restore the DAO Token holders' investments as if the Attack had not occurred. On July 20, 2016, after a majority of the Ethereum network adopted the necessary software updates, the new, forked Ethereum Blockchain became active.[32] The Hard Fork had the effect of transferring all of the funds raised (including those held by the Attacker) from The DAO to a recovery address, where DAO Token holders could exchange their DAO Tokens for ETH.[33] All DAO Token holders

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[28] *See* Stephan Tual, *Proposal #1-DAO Security, Redux*, SLOCK.IT BLOG (May 26, 2016), https://blog.slock.it/both-our-proposals-are-now-out-voting-starts-saturday-morning-ba322d6d3aea. The unnamed security expert would "act as the first point of contact for security disclosures, and continually monitor, pre-empt and avert any potential attack vectors The DAO may face, including social, technical and economic attacks." *Id.* Slock.it initially proposed a much broader security proposal that included the formation of a "DAO Security" group, the establishment of a "Bug Bounty Program," and routine external audits of The DAO's code. However, the cost of the proposal (125,000 ETH), which would be paid from The DAO's funds, was immediately criticized as too high and Slock.it decided instead to submit the revised proposal described above. *See* Stephan Tual, *DAO.Security, a Proposal to guarantee the integrity of The DAO*, SLOCK.IT BLOG (May 25, 2016), https://blog.slock.it/dao-security-a-proposal-to-guarantee-the-integrity-of-the-dao-3473899ace9d.

[29] *See TheDAO Proposal_ID 5*, ETHERSCAN, https://etherscan.io/token/thedao-proposal/5.

[30] *See* Stephan Tual, *DAO Security Advisory: live updates*, SLOCK.IT BLOG (June 17, 2016), https://blog.slock.it/dao-security-advisory-live-updates-2a0a42a2d07b.

[31] *Id.*

[32] A minority group, however, elected not to adopt the new Ethereum Blockchain created by the Hard Fork because to do so would run counter to the concept that a blockchain is immutable. Instead they continued to use the former version of the blockchain, which is now known as "Ethereum Classic."

[33] *See* Christoph Jentzsch, *What the 'Fork' Really Means*, SLOCK.IT BLOG (July 18, 2016), https://blog.slock.it/what-the-fork-really-means-6fe573ac31dd.

who adopted the Hard Fork could exchange their DAO Tokens for ETH, and avoid any loss of the ETH they had invested.[34]

III. Discussion

The Commission is aware that virtual organizations and associated individuals and entities increasingly are using distributed ledger technology to offer and sell instruments such as DAO Tokens to raise capital. These offers and sales have been referred to, among other things, as "Initial Coin Offerings" or "Token Sales." Accordingly, the Commission deems it appropriate and in the public interest to issue this Report in order to stress that the U.S. federal securities law may apply to various activities, including distributed ledger technology, depending on the particular facts and circumstances, without regard to the form of the organization or technology used to effectuate a particular offer or sale. In this Report, the Commission considers the particular facts and circumstances of the offer and sale of DAO Tokens to demonstrate the application of existing U.S. federal securities laws to this new paradigm.

A. Section 5 of the Securities Act

The registration provisions of the Securities Act contemplate that the offer or sale of securities to the public must be accompanied by the "full and fair disclosure" afforded by registration with the Commission and delivery of a statutory prospectus containing information necessary to enable prospective purchasers to make an informed investment decision. Registration entails disclosure of detailed "information about the issuer's financial condition, the identity and background of management, and the price and amount of securities to be offered … ." *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 360 (S.D.N.Y. 1998), *aff'd*, 155 F.3d 129 (2d Cir. 1998). "The registration statement is designed to assure public access to material facts bearing on the value of publicly traded securities and is central to the Act's comprehensive scheme for protecting public investors." *SEC v. Aaron*, 605 F.2d 612, 618 (2d Cir. 1979) (citing *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953)), *vacated on other grounds*, 446 U.S. 680 (1980). Section 5(a) of the Securities Act provides that, unless a registration statement is in effect as to a security, it is unlawful for any person, directly or indirectly, to engage in the offer or sale of securities in interstate commerce. Section 5(c) of the Securities Act provides a similar prohibition against offers to sell, or offers to buy, unless a registration statement has been filed. Thus, both Sections 5(a) and 5(c) of the Securities Act prohibit the unregistered offer or sale of securities in interstate commerce. 15 U.S.C. § 77e(a) and (c). Violations of Section 5 do not require scienter. *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1047 (2d Cir. 1976).

[34] *Id.*

B. DAO Tokens Are Securities

1. Foundational Principles of the Securities Laws Apply to Virtual Organizations or Capital Raising Entities Making Use of Distributed Ledger Technology

Under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, a security includes "an investment contract." *See* 15 U.S.C. §§ 77b-77c. An investment contract is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. *See SEC v. Edwards*, 540 U.S. 389, 393 (2004); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946); *see also United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852-53 (1975) (The "touchstone" of an investment contract "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."). This definition embodies a "*flexible rather than a static principle*, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Howey*, 328 U.S. at 299 (emphasis added). The test "permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" *Id.* In analyzing whether something is a security, "form should be disregarded for substance," *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967), "and the emphasis should be on economic realities underlying a transaction, and not on the name appended thereto." *United Housing Found.*, 421 U.S. at 849.

2. Investors in The DAO Invested Money

In determining whether an investment contract exists, the investment of "money" need not take the form of cash. *See, e.g., Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991) ("[I]n spite of *Howey's* reference to an 'investment of money,' it is well established that cash is not the only form of contribution or investment that will create an investment contract.").

Investors in The DAO used ETH to make their investments, and DAO Tokens were received in exchange for ETH. Such investment is the type of contribution of value that can create an investment contract under *Howey*. *See SEC v. Shavers*, No. 4:13-CV-416, 2014 WL 4652121, at *1 (E.D. Tex. Sept. 18, 2014) (holding that an investment of Bitcoin, a virtual currency, meets the first prong of *Howey*); *Uselton*, 940 F.2d at 574 ("[T]he 'investment' may take the form of 'goods and services,' or some other 'exchange of value'.") (citations omitted).

3. With a Reasonable Expectation of Profits

Investors who purchased DAO Tokens were investing in a common enterprise and reasonably expected to earn profits through that enterprise when they sent ETH to The DAO's Ethereum Blockchain address in exchange for DAO Tokens. "[P]rofits" include "dividends, other periodic payments, or the increased value of the investment." *Edwards*, 540 U.S. at 394. As described above, the various promotional materials disseminated by Slock.it and its co-founders informed investors that The DAO was a for-profit entity whose objective was to fund

projects in exchange for a return on investment.[35] The ETH was pooled and available to The DAO to fund projects. The projects (or "contracts") would be proposed by Contractors. If the proposed contracts were whitelisted by Curators, DAO Token holders could vote on whether The DAO should fund the proposed contracts. Depending on the terms of each particular contract, DAO Token holders stood to share in potential profits from the contracts. Thus, a reasonable investor would have been motivated, at least in part, by the prospect of profits on their investment of ETH in The DAO.

4. Derived from the Managerial Efforts of Others

a. The Efforts of Slock.it, Slock.it's Co-Founders, and The DAO's Curators Were Essential to the Enterprise

Investors' profits were to be derived from the managerial efforts of others—specifically, Slock.it and its co-founders, and The DAO's Curators. The central issue is "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). The DAO's investors relied on the managerial and entrepreneurial efforts of Slock.it and its co-founders, and The DAO's Curators, to manage The DAO and put forth project proposals that could generate profits for The DAO's investors.

Investors' expectations were primed by the marketing of The DAO and active engagement between Slock.it and its co-founders with The DAO and DAO Token holders. To market The DAO and DAO Tokens, Slock.it created The DAO Website on which it published the White Paper explaining how a DAO Entity would work and describing their vision for a DAO Entity. Slock.it also created and maintained other online forums that it used to provide information to DAO Token holders about how to vote and perform other tasks related to their investment. Slock.it appears to have closely monitored these forums, answering questions from DAO Token holders about a variety of topics, including the future of The DAO, security concerns, ground rules for how The DAO would work, and the anticipated role of DAO Token holders. The creators of The DAO held themselves out to investors as experts in Ethereum, the blockchain protocol on which The DAO operated, and told investors that they had selected persons to serve as Curators based on their expertise and credentials. Additionally, Slock.it told investors that it expected to put forth the first substantive profit-making contract proposal—a blockchain venture in its area of expertise. Through their conduct and marketing materials, Slock.it and its co-founders led investors to believe that they could be relied on to provide the significant managerial efforts required to make The DAO a success.

Investors in The DAO reasonably expected Slock.it and its co-founders, and The DAO's Curators, to provide significant managerial efforts after The DAO's launch. The expertise of The DAO's creators and Curators was critical in monitoring the operation of The DAO, safeguarding investor funds, and determining whether proposed contracts should be put for a

[35] That the "projects" could encompass services and the creation of goods for use by DAO Token holders does not change the core analysis that investors purchased DAO Tokens with the expectation of earning profits from the efforts of others.

vote. Investors had little choice but to rely on their expertise. At the time of the offering, The DAO's protocols had already been pre-determined by Slock.it and its co-founders, including the control that could be exercised by the Curators. Slock.it and its co-founders chose the Curators, whose function it was to: (1) vet Contractors; (2) determine whether and when to submit proposals for votes; (3) determine the order and frequency of proposals that were submitted for a vote; and (4) determine whether to halve the default quorum necessary for a successful vote on certain proposals. Thus, the Curators exercised significant control over the order and frequency of proposals, and could impose their own subjective criteria for whether the proposal should be whitelisted for a vote by DAO Token holders. DAO Token holders' votes were limited to proposals whitelisted by the Curators, and, although any DAO Token holder could put forth a proposal, each proposal would follow the same protocol, which included vetting and control by the current Curators. While DAO Token holders could put forth proposals to replace a Curator, such proposals were subject to control by the current Curators, including whitelisting and approval of the new address to which the tokens would be directed for such a proposal. In essence, Curators had the power to determine whether a proposal to remove a Curator was put to a vote.[36]

And, Slock.it and its co-founders did, in fact, actively oversee The DAO. They monitored The DAO closely and addressed issues as they arose, proposing a moratorium on all proposals until vulnerabilities in The DAO's code had been addressed and a security expert to monitor potential attacks on The DAO had been appointed. When the Attacker exploited a weakness in the code and removed investor funds, Slock.it and its co-founders stepped in to help resolve the situation.

b. DAO Token Holders' Voting Rights Were Limited

Although DAO Token holders were afforded voting rights, these voting rights were limited. DAO Token holders were substantially reliant on the managerial efforts of Slock.it, its co-founders, and the Curators.[37] Even if an investor's efforts help to make an enterprise profitable, those efforts do not necessarily equate with a promoter's significant managerial efforts or control over the enterprise. *See, e.g.*, *Glenn W. Turner*, 474 F.2d at 482 (finding that a multi-level marketing scheme was an investment contract and that investors relied on the promoter's managerial efforts, despite the fact that investors put forth the majority of the labor that made the enterprise profitable, because the promoter dictated the terms and controlled the scheme itself); *Long v. Shultz*, 881 F.2d 129, 137 (5th Cir. 1989) ("An investor may authorize the assumption of particular risks that would create the possibility of greater profits or losses but still depend on a third party for all of the essential managerial efforts without which the risk could not

[36] DAO Token holders could put forth a proposal to split from The DAO, which would result in the creation of a new DAO Entity with a new Curator. Other DAO Token holders would be allowed to join the new DAO Entity as long as they voted yes to the original "split" proposal. Unlike all other contract proposals, a proposal to split did not require a deposit or a quorum, and it required a seven-day debating period instead of the minimum two-week debating period required for other proposals.

[37] Because, as described above, DAO Token holders were incentivized either to vote yes or to abstain from voting, the results of DAO Token holder voting would not necessarily reflect the actual view of a majority of DAO Token holders.

pay off."). *See also generally SEC v. Merchant Capital, LLC*, 483 F.3d 747 (11th Cir. 2007) (finding an investment contract even where voting rights were provided to purported general partners, noting that the voting process provided limited information for investors to make informed decisions, and the purported general partners lacked control over the information in the ballots).

The voting rights afforded DAO Token holders did not provide them with meaningful control over the enterprise, because (1) DAO Token holders' ability to vote for contracts was a largely perfunctory one; and (2) DAO Token holders were widely dispersed and limited in their ability to communicate with one another.

First, as discussed above, DAO Token holders could only vote on proposals that had been cleared by the Curators.[38] And that clearance process did not include any mechanism to provide DAO Token holders with sufficient information to permit them to make informed voting decisions. Indeed, based on the particular facts concerning The DAO and the few draft proposals discussed in online forums, there are indications that contract proposals would not have necessarily provide enough information for investors to make an informed voting decision, affording them less meaningful control. For example, the sample contract proposal attached to the White Paper included little information concerning the terms of the contract. Also, the Slock.it co-founders put forth a draft of their own contract proposal and, in response to questions and requests to negotiate the terms of the proposal (posted to a DAO forum), a Slock.it founder explained that the proposal was intentionally vague and that it was, in essence, a take it or leave it proposition not subject to negotiation or feedback. *See, e.g., SEC v. Shields*, 744 F.3d 633, 643-45 (10th Cir. 2014) (in assessing whether agreements were investment contracts, court looked to whether "the investors actually had the type of control reserved under the agreements to obtain access to information necessary to protect, manage, and control their investments at the time they purchased their interests.").

Second, the pseudonymity and dispersion of the DAO Token holders made it difficult for them to join together to effect change or to exercise meaningful control. Investments in The DAO were made pseudonymously (such that the real-world identities of investors are not apparent), and there was great dispersion among those individuals and/or entities who were invested in The DAO and thousands of individuals and/or entities that traded DAO Tokens in the secondary market—an arrangement that bears little resemblance to that of a genuine general partnership. *Cf. Williamson v. Tucker*, 645 F.2d 404, 422-24 (5th Cir. 1981) ("[O]ne would not expect partnership interests sold to large numbers of the general public to provide any real partnership control; at some point there would be so many [limited] partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation.").[39] Slock.it did create and maintain online forums on which

[38] Because, in part, The DAO never commenced its business operations funding projects, this Report does not analyze the question whether anyone associated with The DAO was an "[i]nvestment adviser" under Section 202(a)(11) of the Investment Advisers Act of 1940 ("Advisers Act"). *See* 15 U.S.C. § 80b-2(a)(11). Those who would use virtual organizations should consider their obligations under the Advisers Act.

[39] The Fifth Circuit in *Williamson* stated that:

investors could submit posts regarding contract proposals, which were not limited to use by DAO Token holders (anyone was permitted to post). However, DAO Token holders were pseudonymous, as were their posts to the forums. Those facts, combined with the sheer number of DAO Token holders, potentially made the forums of limited use if investors hoped to consolidate their votes into blocs powerful enough to assert actual control. This was later demonstrated through the fact that DAO Token holders were unable to effectively address the Attack without the assistance of Slock.it and others. The DAO Token holders' pseudonymity and dispersion diluted their control over The DAO. *See Merchant Capital*, 483 F.3d at 758 (finding geographic dispersion of investors weighing against investor control).

These facts diminished the ability of DAO Token holders to exercise meaningful control over the enterprise through the voting process, rendering the voting rights of DAO Token holders akin to those of a corporate shareholder. *Steinhardt Group, Inc. v. Citicorp.*, 126 F.3d 144, 152 (3d Cir. 1997) ("It must be emphasized that the assignment of nominal or limited responsibilities to the participant does not negate the existence of an investment contract; where the duties assigned are so narrowly circumscribed as to involve little real choice of action … a security may be found to exist … . [The] emphasis must be placed on economic reality.") (citing *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 n. 14 (5th Cir. 1974)).

By contract and in reality, DAO Token holders relied on the significant managerial efforts provided by Slock.it and its co-founders, and The DAO's Curators, as described above. Their efforts, not those of DAO Token holders, were the "undeniably significant" ones, essential to the overall success and profitability of any investment into The DAO. *See Glenn W. Turner*, 474 F.2d at 482.

C. Issuers Must Register Offers and Sales of Securities Unless a Valid Exemption Applies

The definition of "issuer" is broadly defined to include "every person who issues or proposes to issue any security" and "person" includes "any unincorporated organization." 15 U.S.C. § 77b(a)(4). The term "issuer" is flexibly construed in the Section 5 context "as issuers devise new ways to issue their securities and the definition of a security itself expands." *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 909 (5th Cir. 1977); *accord SEC v. Murphy*, 626 F.2d 633, 644 (9th Cir. 1980) ("[W]hen a person [or entity] organizes or sponsors the organization of

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> A general partnership or joint venture interest can be designated a security if the investor can establish, for example, that (1) an agreement among the parties leaves so little power in the hands of the partner or venture that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Williamson, 645 F.2d at 424 & n.15 (court also noting that, "this is not to say that other factors could not also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be effectively precluded.").

limited partnerships and is primarily responsible for the success or failure of the venture for which the partnership is formed, he will be considered an issuer … .").

The DAO, an unincorporated organization, was an issuer of securities, and information about The DAO was "crucial" to the DAO Token holders' investment decision. *See Murphy*, 626 F.2d at 643 ("Here there is no company issuing stock, but instead, a group of individuals investing funds in an enterprise for profit, and receiving in return an entitlement to a percentage of the proceeds of the enterprise.") (citation omitted). The DAO was "responsible for the success or failure of the enterprise," and accordingly was the entity about which the investors needed information material to their investment decision. *Id.* at 643-44.

During the Offering Period, The DAO offered and sold DAO Tokens in exchange for ETH through The DAO Website, which was publicly-accessible, including to individuals in the United States. During the Offering Period, The DAO sold approximately 1.15 billion DAO Tokens in exchange for a total of approximately 12 million ETH, which was valued in USD, at the time, at approximately $150 million. Because DAO Tokens were securities, The DAO was required to register the offer and sale of DAO Tokens, unless a valid exemption from such registration applied.

Moreover, those who participate in an unregistered offer and sale of securities not subject to a valid exemption are liable for violating Section 5. *See, e.g.*, *Murphy*, 626 F.2d at 650-51 ("[T]hose who ha[ve] a necessary role in the transaction are held liable as participants.") (citing *SEC v. North Am. Research & Dev. Corp.*, 424 F.2d 63, 81 (2d Cir. 1970); *SEC v. Culpepper*, 270 F.2d 241, 247 (2d Cir. 1959); *SEC v. International Chem. Dev. Corp.*, 469 F.2d 20, 28 (10th Cir. 1972); *Pennaluna & Co. v. SEC*, 410 F.2d 861, 864 n.1, 868 (9th Cir. 1969)); *SEC v. Softpoint, Inc.*, 958 F. Supp 846, 859-60 (S.D.N.Y. 1997) ("The prohibitions of Section 5 … sweep[] broadly to encompass 'any person' who participates in the offer or sale of an unregistered, non-exempt security."); *SEC v. Chinese Consol. Benevolent Ass'n.*, 120 F.2d 738, 740-41 (2d Cir. 1941) (defendant violated Section 5(a) "because it engaged in selling unregistered securities" issued by a third party "when it solicited offers to buy the securities 'for value'").

D. A System that Meets the Definition of an Exchange Must Register as a National Securities Exchange or Operate Pursuant to an Exemption from Such Registration

Section 5 of the Exchange Act makes it unlawful for any broker, dealer, or exchange, directly or indirectly, to effect any transaction in a security, or to report any such transaction, in interstate commerce, unless the exchange is registered as a national securities exchange under Section 6 of the Exchange Act, or is exempted from such registration. *See* 15 U.S.C. §78e. Section 3(a)(1) of the Exchange Act defines an "exchange" as "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood … ." 15 U.S.C. § 78c(a)(1).

Exchange Act Rule 3b-16(a) provides a functional test to assess whether a trading system meets the definition of exchange under Section 3(a)(1). Under Exchange Act Rule 3b-16(a), an

organization, association, or group of persons shall be considered to constitute, maintain, or provide "a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange," if such organization, association, or group of persons: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of the trade.[40]

A system that meets the criteria of Rule 3b-16(a), and is not excluded under Rule 3b-16(b), must register as a national securities exchange pursuant to Sections 5 and 6 of the Exchange Act[41] or operate pursuant to an appropriate exemption. One frequently used exemption is for alternative trading systems ("ATS").[42] Rule 3a1-1(a)(2) exempts from the definition of "exchange" under Section 3(a)(1) an ATS that complies with Regulation ATS,[43] which includes, among other things, the requirement to register as a broker-dealer and file a Form ATS with the Commission to provide notice of the ATS's operations. Therefore, an ATS that operates pursuant to the Rule 3a1-1(a)(2) exemption and complies with Regulation ATS would not be subject to the registration requirement of Section 5 of the Exchange Act.

The Platforms that traded DAO Tokens appear to have satisfied the criteria of Rule 3b-16(a) and do not appear to have been excluded from Rule 3b-16(b). As described above, the Platforms provided users with an electronic system that matched orders from multiple parties to buy and sell DAO Tokens for execution based on non-discretionary methods.

IV. Conclusion and References for Additional Guidance

Whether or not a particular transaction involves the offer and sale of a security—regardless of the terminology used—will depend on the facts and circumstances, including the

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[40] *See* 17 C.F.R. § 240.3b-16(a). The Commission adopted Rule 3b-16(b) to exclude explicitly certain systems that the Commission believed did not meet the exchange definition. These systems include systems that merely route orders to other execution facilities and systems that allow persons to enter orders for execution against the bids and offers of a single dealer system. *See* Securities Exchange Act Rel. No. 40760 (Dec. 8, 1998), 63 FR 70844 (Dec. 22, 1998) (Regulation of Exchanges and Alternative Trading Systems) ("Regulation ATS"), 70852.

[41] 15 U.S.C. § 78e. A "national securities exchange" is an exchange registered as such under Section 6 of the Exchange Act. 15 U.S.C. § 78f.

[42] Rule 300(a) of Regulation ATS promulgated under the Exchange Act provides that an ATS is:

> any organization, association, person, group of persons, or system: (1) [t]hat constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Exchange Act Rule 3b-16]; and (2) [t]hat does not: (i) [s]et rules governing the conduct of subscribers other than the conduct of subscribers' trading on such [ATS]; or (ii) [d]iscipline subscribers other than by exclusion from trading.

Regulation ATS, *supra* note 40, Rule 300(a).

[43] *See* 17 C.F.R. § 240.3a1-1(a)(2). Rule 3a1-1 also provides two other exemptions from the definition of "exchange" for any ATS operated by a national securities association, and any ATS not required to comply with Regulation ATS pursuant to Rule 301(a) of Regulation ATS. *See* 17 C.F.R. §§ 240.3a1-1(a)(1) and (3).

economic realities of the transaction. Those who offer and sell securities in the United States must comply with the federal securities laws, including the requirement to register with the Commission or to qualify for an exemption from the registration requirements of the federal securities laws. The registration requirements are designed to provide investors with procedural protections and material information necessary to make informed investment decisions. These requirements apply to those who offer and sell securities in the United States, regardless whether the issuing entity is a traditional company or a decentralized autonomous organization, regardless whether those securities are purchased using U.S. dollars or virtual currencies, and regardless whether they are distributed in certificated form or through distributed ledger technology. In addition, any entity or person engaging in the activities of an exchange, such as bringing together the orders for securities of multiple buyers and sellers using established non-discretionary methods under which such orders interact with each other and buyers and sellers entering such orders agree upon the terms of the trade, must register as a national securities exchange or operate pursuant to an exemption from such registration.

To learn more about registration requirements under the Securities Act, please visit the Commission's website here. To learn more about the Commission's registration requirements for investment companies, please visit the Commission's website here. To learn more about the Commission's registration requirements for national securities exchanges, please visit the Commission's website here. To learn more about alternative trading systems, please see the Regulation ATS adopting release here.

For additional guidance, please see the following Commission enforcement actions involving virtual currencies:

- *SEC v. Trendon T. Shavers and Bitcoin Savings and Trust*, Civil Action No. 4:13-CV-416 (E.D. Tex., complaint filed July 23, 2013)
- *In re Erik T. Voorhees*, Rel. No. 33-9592 (June 3, 2014)
- *In re BTC Trading, Corp. and Ethan Burnside*, Rel. No. 33-9685 (Dec. 8, 2014)
- *SEC v. Homero Joshua Garza, Gaw Miners, LLC, and ZenMiner, LLC (d/b/a Zen Cloud)*, Civil Action No. 3:15-CV-01760 (D. Conn., complaint filed Dec. 1, 2015)
- *In re Bitcoin Investment Trust and SecondMarket, Inc.*, Rel. No. 34-78282 (July 11, 2016)
- *In re Sunshine Capital, Inc*., File No. 500-1 (Apr. 11, 2017)

And please see the following investor alerts:

- *Bitcoin and Other Virtual Currency-Related Investments* (May 7, 2014)
- *Ponzi Schemes Using Virtual Currencies* (July 2013)

By the Commission.

Exhibit B

Investor Alerts and Bulletins

Investor Alert: Public Companies Making ICO-Related Claims

Aug. 28, 2017

The SEC's Office of Investor Education and Advocacy is warning investors about potential scams involving stock of companies claiming to be related to, or asserting they are engaging in, Initial Coin Offerings (or ICOs). Fraudsters often try to use the lure of new and emerging technologies to convince potential victims to invest their money in scams. These frauds include "pump-and-dump" and market manipulation schemes involving publicly traded companies that claim to provide exposure to these new technologies.

Recent Trading Suspensions

Developers, businesses, and individuals increasingly are using ICOs – also called coin or token launches or sales – to raise capital. There has been media attention regarding this form of capital raising. While these activities may provide fair and lawful investment opportunities, there may be situations in which companies are publicly announcing ICO or coin/token related events to affect the price of the company's common stock.

The SEC may suspend trading in a stock when the SEC is of the opinion that a suspension is required to protect investors and the public interest. Circumstances that might lead to a trading suspension include:

- A lack of current, accurate, or adequate information about the company – for example, when a company has not filed any periodic reports for an extended period;
- Questions about the accuracy of publicly available information, including in company press releases and reports, about the company's current operational status and financial condition; or
- Questions about trading in the stock, including trading by insiders, potential market manipulation, and the ability to clear and settle transactions in the stock.

The SEC recently issued several trading suspensions on the common stock of certain issuers who made claims regarding their investments in ICOs or touted coin/token related news. The companies affected by trading suspensions include First Bitcoin Capital Corp., CIAO Group, Strategic Global, and Sunshine Capital.

Investors should be very cautious in considering an investment in a stock following a trading suspension. A trading suspension is one warning sign of possible microcap fraud (microcap stocks, some of which are penny stocks and/or nanocap stocks, tend to be low priced and trade in low volumes). If current, reliable information about a company and its stock is not available, investors

should consider seriously the risk of making an investment in the company's stock. *For more on trading suspensions, see our Investor Bulletin: Trading in Stock after an SEC Trading Suspension – Be Aware of the Risks.*

Pump-and-Dump and Market Manipulations

One way fraudsters seek to profit is by engaging in market manipulation, such as by spreading false and misleading information about a company (typically microcap stocks) to affect the stock's share price. They may spread stock rumors in different ways, including on company websites, press releases, email spam, and posts on social media, online bulletin boards, and chat rooms. The false or misleading rumors may be positive or negative.

For example, "pump-and-dump" schemes involve the effort to manipulate a stock's share price or trading volume by touting the company's stock through false and misleading statements to the marketplace. Pump-and-dump schemes often occur on the Internet where it is common to see messages posted that urge readers to buy a stock quickly or to sell before the price goes down, or a promoter will call using the same sort of pitch. In reality, the author of the messages may be a company insider or paid promoter who stands to gain by selling their shares after the stock price is "pumped" up by the buying frenzy they create. Once these fraudsters "dump" their shares for a profit and stop hyping the stock, the price typically falls, and investors lose their money. *Learn more about these schemes in our Updated Investor Alert: Fraudulent Stock Promotions.*

Tips for Investors

- Always research a company before buying its stock, especially following a trading suspension. Consider the company's finances, organization, and business prospects. This type of information often is included in filings that a company makes with the SEC, which are available for free and can be found in the Commission's EDGAR filing system.
- Some companies are not required to file reports with the SEC. These are known as "non-reporting" companies. Investors should be aware of the risks of trading the stock of such companies, as there may not be current and accurate information that would allow investors to make an informed investment decision.
- Investors should also do their own research and be aware that information from online blogs, social networking sites, and even a company's own website may be inaccurate and potentially intentionally misleading.
- Be especially cautious regarding stock promotions, including related to new technologies such as ICOs. Look out for these warning signs of possible ICO-related fraud:
    - Company that has common stock trading claims that its ICO is "SEC-compliant" without explaining how the offering is in compliance with the securities laws; or
    - Company that has common stock trading also purports to raise capital through an ICO or take on ICO-related business described in vague or nonsensical terms or using undefined technical or legal jargon.
- Look out for these warning signs of possible microcap fraud:
    - SEC suspended public trading of the security or other securities promoted by the same promoter;

- Increase in stock price or trading volume happening at the same time as the promotional activity;
- Press releases or promotional activity announcing events that ultimately do not happen (*e.g.,* multiple announcements of preliminary deals or agreements; announcements of deals with unnamed partners; announcements using hyperbolic language);
- Company has no real business operations (few assets, or minimal gross revenues);
- Company issues a lot of shares without a corresponding increase in the company's assets; and
- Frequent changes in company name, management, or type of business.

Additional Resources

Investor Bulletin: Initial Coin Offerings

Updated Investor Alert: Social Media and Investing -- Stock Rumors

Investor Alert: Be Aware of Stock Recommendations On Investment Research Websites

Report possible securities fraud to the SEC. Report a problem or ask the SEC a question.
Visit Investor.gov, the SEC's website for individual investors.

Modified: Aug. 28, 2017

Exhibit C

Press Release

SEC Suspends Trading in Three Issuers Claiming Involvement in Cryptocurrency and Blockchain Technology

FOR IMMEDIATE RELEASE
2018-20

Washington D.C., Feb. 16, 2018 — The Securities and Exchange Commission today suspended trading in three companies amid questions surrounding similar statements they made about the acquisition of cryptocurrency and blockchain technology-related assets.

The SEC's trading suspension orders state that recent press releases issued by Cherubim Interests Inc. (CHIT), PDX Partners Inc. (PDXP), and Victura Construction Group Inc. (VICT) claimed that CHIT, PDXP, and VICT acquired AAA-rated assets from a subsidiary of a private equity investor in cryptocurrency and blockchain technology among other things. According to the SEC order regarding CHIT, it also announced the execution of a financing commitment to launch an initial coin offering.

According to the SEC's orders, there are questions regarding the nature of the companies' business operations and the value of their assets, including in press releases issued beginning in early January 2018. Additionally, the Commission suspended trading in the securities of CHIT because of its delinquency in filing annual and quarterly reports.

In August 2017, the SEC warned investors to be on alert for companies that may publicly announce ICO or coin/token related events to affect the price of the company's common stock.

"This is a reminder that investors should give heightened scrutiny to penny stock companies that have switched their focus to the latest business trend, such as cryptocurrency, blockchain technology, or initial coin offerings," said Michele Wein Layne, Director of the Los Angeles Regional Office.

Under the federal securities laws, the SEC can suspend trading in a stock for 10 days and generally prohibit a broker-dealer from soliciting investors to buy or sell the stock again until certain reporting requirements are met.

The SEC appreciates the assistance of OTC Markets Group Inc. and the Financial Industry Regulatory Authority.

The SEC's Office of Investor Education and Advocacy has produced a Spotlight on Initial Coin Offerings and Digital Assets to provide investors with more information.

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Related Materials

- Trading Suspension Order - CHIT
- Trading Suspension Order - PDXP
- Trading Suspension Order - VICT

Exhibit D

Public Statement

Statement on Cryptocurrencies and Initial Coin Offerings

SEC Chairman Jay Clayton

Dec. 11, 2017

The world's social media platforms and financial markets are abuzz about cryptocurrencies and "initial coin offerings" (*ICOs*). There are tales of fortunes made and dreamed to be made. We are hearing the familiar refrain, "this time is different."

The cryptocurrency and ICO markets have grown rapidly. These markets are local, national and international and include an ever-broadening range of products and participants. They also present investors and other market participants with many questions, some new and some old (but in a new form), including, to list just a few:

- Is the product legal? Is it subject to regulation, including rules designed to protect investors? Does the product comply with those rules?
- Is the offering legal? Are those offering the product licensed to do so?
- Are the trading markets fair? Can prices on those markets be manipulated? Can I sell when I want to?
- Are there substantial risks of theft or loss, including from hacking?

The answers to these and other important questions often require an in-depth analysis, and the answers will differ depending on many factors. This statement provides my general views on the cryptocurrency and ICO markets[1] and is directed principally to two groups:

- "Main Street" investors, and
- Market professionals – including, for example, broker-dealers, investment advisers, exchanges, lawyers and accountants – whose actions impact Main Street investors.

Considerations for Main Street Investors

A number of concerns have been raised regarding the cryptocurrency and ICO markets, including that, as they are currently operating, there is substantially less investor protection than in our traditional securities markets, with correspondingly greater opportunities for fraud and manipulation.

Investors should understand that to date no initial coin offerings have been registered with the SEC. The SEC also has not to date approved for listing and trading any exchange-traded products (such as

ETFs) holding cryptocurrencies or other assets related to cryptocurrencies.[2] **If any person today tells you otherwise, be especially wary.**

We have issued investor alerts, bulletins and statements on initial coin offerings and cryptocurrency-related investments, including with respect to the marketing of certain offerings and investments by celebrities and others.[3] Please take a moment to read them. **If you choose to invest in these products, please ask questions and demand clear answers.** A list of sample questions that may be helpful is attached.

As with any other type of potential investment, if a promoter guarantees returns, if an opportunity sounds too good to be true, or if you are pressured to act quickly, please exercise extreme caution and be aware of the risk that your investment may be lost.

Please also recognize that these markets span national borders and that significant trading may occur on systems and platforms outside the United States. Your invested funds may quickly travel overseas without your knowledge. As a result, risks can be amplified, including the risk that market regulators, such as the SEC, may not be able to effectively pursue bad actors or recover funds.

To learn more about these markets and their regulation, please read the "Additional Discussion of Cryptocurrencies, ICOs and Securities Regulation" section below.

Considerations for Market Professionals

I believe that initial coin offerings – whether they represent offerings of securities or not – can be effective ways for entrepreneurs and others to raise funding, including for innovative projects. However, any such activity that involves an offering of securities must be accompanied by the important disclosures, processes and other investor protections that our securities laws require. A change in the structure of a securities offering does not change the fundamental point that when a security is being offered, our securities laws must be followed.[4] Said another way, replacing a traditional corporate interest recorded in a central ledger with an enterprise interest recorded through a blockchain entry on a distributed ledger may change the form of the transaction, but it does not change the substance.

I urge market professionals, including securities lawyers, accountants and consultants, to read closely the investigative report we released earlier this year (the "*21(a) Report*")[5] and review our subsequent enforcement actions.[6] In the 21(a) Report, the Commission applied longstanding securities law principles to demonstrate that a particular token constituted an investment contract and therefore was a security under our federal securities laws. Specifically, we concluded that the token offering represented an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

Following the issuance of the 21(a) Report, certain market professionals have attempted to highlight utility characteristics of their proposed initial coin offerings in an effort to claim that their proposed tokens or coins are not securities. Many of these assertions appear to elevate form over substance. Merely calling a token a "utility" token or structuring it to provide some utility does not prevent the token from being a security. Tokens and offerings that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others continue to contain the hallmarks of a security under U.S. law. **On this and other points where the application of expertise and judgment is expected, I believe that gatekeepers and others,**

including securities lawyers, accountants and consultants, need to focus on their responsibilities. I urge you to be guided by the principal motivation for our registration, offering process and disclosure requirements: investor protection and, in particular, the protection of our Main Street investors.

I also caution market participants against promoting or touting the offer and sale of coins without first determining whether the securities laws apply to those actions. **Selling securities generally requires a license, and experience shows that excessive touting in thinly traded and volatile markets can be an indicator of "scalping," "pump and dump" and other manipulations and frauds.** Similarly, I also caution those who operate systems and platforms that effect or facilitate transactions in these products that they may be operating unregistered exchanges or broker-dealers that are in violation of the Securities Exchange Act of 1934.

On cryptocurrencies, I want to emphasize two points. First, while there are cryptocurrencies that do not appear to be securities, simply calling something a "currency" or a currency-based product does not mean that it is not a security. Before launching a cryptocurrency or a product with its value tied to one or more cryptocurrencies, its promoters must either (1) be able to demonstrate that the currency or product is not a security or (2) comply with applicable registration and other requirements under our securities laws. Second, brokers, dealers and other market participants that allow for payments in cryptocurrencies, allow customers to purchase cryptocurrencies on margin, or otherwise use cryptocurrencies to facilitate securities transactions should exercise particular caution, including ensuring that their cryptocurrency activities are not undermining their anti-money laundering and know-your-customer obligations.[7] **As I have stated previously, these market participants should treat payments and other transactions made in cryptocurrency as if cash were being handed from one party to the other.**

Additional Discussion of Cryptocurrencies, ICOs and Securities Regulation

Cryptocurrencies. Speaking broadly, cryptocurrencies purport to be items of inherent value (similar, for instance, to cash or gold) that are designed to enable purchases, sales and other financial transactions. They are intended to provide many of the same functions as long-established currencies such as the U.S. dollar, euro or Japanese yen but do not have the backing of a government or other body. Although the design and maintenance of cryptocurrencies differ, proponents of cryptocurrencies highlight various potential benefits and features of them, including (1) the ability to make transfers without an intermediary and without geographic limitation, (2) finality of settlement, (3) lower transaction costs compared to other forms of payment and (4) the ability to publicly verify transactions. Other often-touted features of cryptocurrencies include personal anonymity and the absence of government regulation or oversight. Critics of cryptocurrencies note that these features may facilitate illicit trading and financial transactions, and that some of the purported beneficial features may not prove to be available in practice.

It has been asserted that cryptocurrencies are not securities and that the offer and sale of cryptocurrencies are beyond the SEC's jurisdiction. Whether that assertion proves correct with respect to any digital asset that is labeled as a cryptocurrency will depend on the characteristics and use of that particular asset. In any event, it is clear that, just as the SEC has a sharp focus on how U.S. dollar, euro and Japanese yen transactions affect our securities markets, we have the same interests and responsibilities with respect to cryptocurrencies. This extends, for example, to securities firms and other market participants that allow payments to be made in cryptocurrencies, set up structures to invest in or hold cryptocurrencies, or extend credit to customers to purchase or hold cryptocurrencies.

Initial Coin Offerings. Coinciding with the substantial growth in cryptocurrencies, companies and individuals increasingly have been using initial coin offerings to raise capital for their businesses and projects. Typically these offerings involve the opportunity for individual investors to exchange currency such as U.S. dollars or cryptocurrencies in return for a digital asset labeled as a coin or token.

These offerings can take many different forms, and the rights and interests a coin is purported to provide the holder can vary widely. A key question for all ICO market participants: "Is the coin or token a security?" As securities law practitioners know well, the answer depends on the facts. For example, a token that represents a participation interest in a book-of-the-month club may not implicate our securities laws, and may well be an efficient way for the club's operators to fund the future acquisition of books and facilitate the distribution of those books to token holders. In contrast, many token offerings appear to have gone beyond this construct and are more analogous to interests in a yet-to-be-built publishing house with the authors, books and distribution networks all to come. It is especially troubling when the promoters of these offerings emphasize the secondary market trading potential of these tokens. Prospective purchasers are being sold on the potential for tokens to increase in value – with the ability to lock in those increases by reselling the tokens on a secondary market – or to otherwise profit from the tokens based on the efforts of others. These are key hallmarks of a security and a securities offering.

By and large, the structures of initial coin offerings that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws. Generally speaking, these laws provide that investors deserve to know what they are investing in and the relevant risks involved.

I have asked the SEC's Division of Enforcement to continue to police this area vigorously and recommend enforcement actions against those that conduct initial coin offerings in violation of the federal securities laws.

Conclusion

We at the SEC are committed to promoting capital formation. The technology on which cryptocurrencies and ICOs are based may prove to be disruptive, transformative and efficiency enhancing. I am confident that developments in fintech will help facilitate capital formation and provide promising investment opportunities for institutional and Main Street investors alike.

I encourage Main Street investors to be open to these opportunities, but to ask good questions, demand clear answers and apply good common sense when doing so. When advising clients, designing products and engaging in transactions, market participants and their advisers should thoughtfully consider our laws, regulations and guidance, as well as our principles-based securities law framework, which has served us well in the face of new developments for more than 80 years. I also encourage market participants and their advisers to engage with the SEC staff to aid in their analysis under the securities laws. Staff providing assistance on these matters remain available at FinTech@sec.gov .

Sample Questions for Investors Considering a Cryptocurrency or ICO Investment Opportunity[8]

- Who exactly am I contracting with?

    - Who is issuing and sponsoring the product, what are their backgrounds, and have they provided a full and complete description of the product? Do they have a clear written business plan that I understand?
    - Who is promoting or marketing the product, what are their backgrounds, and are they licensed to sell the product? Have they been paid to promote the product?
    - Where is the enterprise located?
- Where is my money going and what will it be used for? Is my money going to be used to "cash out" others?
- What specific rights come with my investment?
- Are there financial statements? If so, are they audited, and by whom?
- Is there trading data? If so, is there some way to verify it?
- How, when, and at what cost can I sell my investment? For example, do I have a right to give the token or coin back to the company or to receive a refund? Can I resell the coin or token, and if so, are there any limitations on my ability to resell?
- If a digital wallet is involved, what happens if I lose the key? Will I still have access to my investment?
- If a blockchain is used, is the blockchain open and public? Has the code been published, and has there been an independent cybersecurity audit?
- Has the offering been structured to comply with the securities laws and, if not, what implications will that have for the stability of the enterprise and the value of my investment?
- What legal protections may or may not be available in the event of fraud, a hack, malware, or a downturn in business prospects? Who will be responsible for refunding my investment if something goes wrong?
- If I do have legal rights, can I effectively enforce them and will there be adequate funds to compensate me if my rights are violated?

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[1] This statement is my own and does not reflect the views of any other Commissioner or the Commission. This statement is not, and should not be taken as, a definitive discussion of applicable law, all the relevant risks with respect to these products, or a statement of my position on any particular product. Additionally, this statement is not a comment on any particular submission, in the form of a proposed rule change or otherwise, pending before the Commission.

[2] The CFTC has designated bitcoin as a commodity. Fraud and manipulation involving bitcoin traded in interstate commerce are appropriately within the purview of the CFTC, as is the regulation of commodity futures tied directly to bitcoin. That said, products linked to the value of underlying digital assets, including bitcoin and other cryptocurrencies, may be structured as securities products subject to registration under the Securities Act of 1933 or the Investment Company Act of 1940.

[3] Statement on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others (Nov. 1, 2017), *available at* https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos; Investor Alert: Public Companies Making ICO-Related Claims (Aug. 28, 2017), *available at* https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_icorelatedclaims; Investor Bulletin: Initial Coin Offerings (July 25, 2017), *available at*

https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings; Investor Alert: Bitcoin and Other Virtual Currency-Related Investments (May 7, 2014), *available at* https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-bitcoin-other-virtual-currency; Investor Alert: Ponzi Schemes Using Virtual Currencies (July 23, 2013), *available at* https://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf.

[4] It is possible to conduct an ICO without triggering the SEC's registration requirements. For example, just as with a Regulation D exempt offering to raise capital for the manufacturing of a physical product, an initial coin offering that is a security can be structured so that it qualifies for an applicable exemption from the registration requirements.

[5] 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.

[6] Press Release, Company Halts ICO After SEC Raises Registration Concerns (Dec. 11, 2017), *available at* https://www.sec.gov/news/press-release/2017-227; Press Release, SEC Emergency Action Halts ICO Scam (Dec. 4, 2017), *available at* https://www.sec.gov/news/press-release/2017-219; Press Release, SEC Exposes Two Initial Coin Offerings Purportedly Backed by Real Estate and Diamonds (Sept. 29, 2017), *available at* https://www.sec.gov/news/press-release/2017-185-0.

[7] I am particularly concerned about market participants who extend to customers credit in U.S. dollars – a relatively stable asset – to enable the purchase of cryptocurrencies, which, in recent experience, have proven to be a more volatile asset.

[8] This is not intended to represent an exhaustive list. Please also see the SEC investor bulletins, alerts and statements referenced in note 3 of this statement.

Exhibit E

Investor.gov
U.S. SECURITIES AND EXCHANGE COMMISSION

INVESTOR BULLETIN: INITIAL COIN OFFERINGS

07/25/2017

Developers, businesses, and individuals increasingly are using initial coin offerings, also called ICOs or token sales, to raise capital. These activities may provide fair and lawful investment opportunities. However, new technologies and financial products, such as those associated with ICOs, can be used improperly to entice investors with the promise of high returns in a new investment space. The SEC's Office of Investor Education and Advocacy is issuing this Investor Bulletin to make investors aware of potential risks of participating in ICOs.

Background – Initial Coin Offerings

Virtual coins or tokens are created and disseminated using distributed ledger or blockchain technology. Recently promoters have been selling virtual coins or tokens in ICOs. Purchasers may use fiat currency (e.g., U.S. dollars) or virtual currencies to buy these virtual coins or tokens. Promoters may tell purchasers that the capital raised from the sales will be used to fund development of a digital platform, software, or other projects and that the virtual tokens or coins may be used to access the platform, use the software, or otherwise participate in the project. Some promoters and initial sellers may lead buyers of the virtual coins or tokens to expect a return on their investment or to participate in a share of the returns provided by the project. After they are issued, the virtual coins or tokens may be resold to others in a secondary market on virtual currency exchanges or other platforms.

Depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities. If they are securities, the offer and sale of these virtual coins or tokens in an ICO are subject to the federal securities laws.

> On July 25, 2017, the SEC issued a Report of Investigation under Section 21(a) (https://www.sec.gov/litigation/investreport/34-81207.pdf) of the Securities Exchange Act of 1934 describing an SEC investigation of The DAO, a virtual organization, and its use of distributed ledger or blockchain technology to facilitate the offer and sale of DAO Tokens to raise capital. The Commission applied existing U.S. federal securities laws to this new paradigm, determining that DAO Tokens were securities. The Commission stressed that those who offer and sell securities in the U.S. are required to comply with federal securities laws, regardless of whether those securities are purchased with virtual currencies or distributed with blockchain technology.

To facilitate understanding of this new and complex area, here are some basic concepts that you should understand before investing in virtual coins or tokens:

What is a blockchain?

A blockchain is an electronic distributed ledger or list of entries – much like a stock ledger – that is maintained by various participants in a network of computers. Blockchains use cryptography to process and verify transactions on the ledger, providing comfort to users and potential users of the blockchain that entries are secure. Some examples of blockchain are the Bitcoin and Ethereum blockchains, which are used to create and track transactions in bitcoin and ether, respectively.

What is a virtual currency or virtual token or coin?

A virtual currency is a digital representation of value that can be digitally traded and functions as a medium of exchange, unit of account, or store of value. Virtual tokens or coins may represent other rights as well. Accordingly, in certain cases, the tokens or coins will be securities and may not be lawfully sold without registration with the SEC or pursuant to an exemption from registration.

What is a virtual currency exchange?

A virtual currency exchange is a person or entity that exchanges virtual currency for fiat currency, funds, or other forms of virtual currency. Virtual currency exchanges typically charge fees for these services. Secondary market trading of virtual tokens or coins may also occur on an exchange. These exchanges may not be registered securities exchanges or alternative trading systems regulated under the federal securities laws. Accordingly, in purchasing and selling virtual coins and tokens, you may not have the same protections that would apply in the case of stocks listed on an exchange.

Who issues virtual tokens or coins?

Virtual tokens or coins may be issued by a virtual organization or other capital raising entity. A virtual organization is an organization embodied in computer code and executed on a distributed ledger or blockchain. The code, often called a "smart contract," serves to automate certain functions of the organization, which may include the issuance of certain virtual coins or tokens. The DAO, which was a decentralized autonomous organization, is an example of a virtual organization.

Some Key Points to Consider When Determining Whether to Participate in an ICO

If you are thinking about participating in an ICO, here are some things you should consider.

▶ Depending on the facts and circumstances, the offering may involve the offer and sale of securities. If that is the case, the offer and sale of virtual coins or tokens must itself be registered with the SEC, or be performed pursuant to an exemption from registration. Before investing in an ICO, ask whether the virtual tokens or coins are securities and whether the persons selling them registered the offering with the SEC. A few things to keep in mind about registration:

- If an offering is registered, you can find information (such as a registration statement or "Form S-1") on SEC.gov (https://www.sec.gov/) through EDGAR (https://investor.gov/research-before-you-invest/research/researching-investments/using-edgar-researching-public-companies).
- If a promoter states that an offering is exempt from registration, and you are not an accredited investor (https://investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-accredited-investors), you should be very careful – most exemptions have net worth or income requirements.
- Although ICOs are sometimes described as crowdfunding (https://investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-crowdfunding-investors) contracts, it is possible that

they are not being offered and sold in compliance with the requirements of Regulation Crowdfunding or with the federal securities laws generally.

- Ask what your money will be used for and what rights the virtual coin or token provides to you. The promoter should have a clear business plan that you can read and that you understand. The rights the token or coin entitles you to should be clearly laid out, often in a white paper or development roadmap. You should specifically ask about how and when you can get your money back in the event you wish to do so. For example, do you have a right to give the token or coin back to the company or to receive a refund? Or can you resell the coin or token? Are there any limitations on your ability to resell the coin or token?

- If the virtual token or coin is a security, federal and state securities laws require investment professionals and their firms who offer, transact in, or advise on investments to be licensed or registered. You can visit Investor.gov (https://www.investor.gov/) to check the registration status and background of these investment professionals.

- Ask whether the blockchain is open and public, whether the code has been published, and whether there has been an independent cybersecurity audit.

- Fraudsters often use innovations and new technologies to perpetrate fraudulent investment schemes. Fraudsters may entice investors by touting an ICO investment "opportunity" as a way to get into this cutting-edge space, promising or guaranteeing high investment returns. Investors should always be suspicious of jargon-laden pitches, hard sells, and promises of outsized returns. Also, it is relatively easy for anyone to use blockchain technology to create an ICO that looks impressive, even though it might actually be a scam.

- Virtual currency exchanges and other entities holding virtual currencies, virtual tokens or coins may be susceptible to fraud, technical glitches, hacks, or malware. Virtual tokens or virtual currency may be stolen by hackers.

Investing in an ICO may limit your recovery in the event of fraud or theft. While you may have rights under the federal securities laws, your ability to recover may be significantly limited.

If fraud or theft results in you or the organization that issued the virtual tokens or coins losing virtual tokens, virtual currency, or fiat currency, you may have limited recovery options. Third-party wallet services, payment processors, and virtual currency exchanges that play important roles in the use of virtual currencies may be located overseas or be operating unlawfully.

Law enforcement officials may face particular challenges when investigating ICOs and, as a result, investor remedies may be limited. These challenges include:

- Tracing money. Traditional financial institutions (such as banks) often are not involved with ICOs or virtual currency transactions, making it more difficult to follow the flow of money.

- International scope. ICOs and virtual currency transactions and users span the globe. Although the SEC regularly obtains information from abroad (such as through cross-border agreements), there may be restrictions on how the SEC can use the information and it may take more time to get the information. In some cases, the SEC may be unable to obtain information from persons or entities located overseas.

- No central authority. As there is no central authority that collects virtual currency user information, the SEC generally must rely on other sources for this type of information.

- Freezing or securing virtual currency. Law enforcement officials may have difficulty freezing or securing investor funds that are held in a virtual currency. Virtual currency wallets are encrypted and unlike money held in a bank or brokerage account, virtual currencies may not be held by a third-party custodian.

Be careful if you spot any of these potential warning signs of investment fraud.

- "Guaranteed" high investment returns. There is no such thing as guaranteed high investment returns. Be wary of anyone who promises that you will receive a high rate of return on your investment, with little or no risk.

- Unsolicited offers. An unsolicited sales pitch may be part of a fraudulent investment scheme. Exercise extreme caution if you receive an unsolicited communication—meaning you didn't ask for it and don't know the sender—about an investment opportunity.

- Sounds too good to be true. If the investment sounds too good to be true, it probably is. Remember that investments providing higher returns typically involve more risk.

- Pressure to buy RIGHT NOW. Fraudsters may try to create a false sense of urgency to get in on the investment. Take your time researching an investment opportunity before handing over your money.

- Unlicensed sellers. Many fraudulent investment schemes involve unlicensed individuals or unregistered firms. Check license and registration status on Investor.gov (https://investor.gov/).

- No net worth or income requirements. The federal securities laws require securities offerings to be registered with the SEC unless an exemption from registration applies. Many registration exemptions require that investors are accredited investors (http://www.sec.gov/answers/accred.htm); some others have investment limits. Be highly suspicious of private (*i.e.,* unregistered) investment opportunities that do not ask about your net worth or income or whether investment limits apply.

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Before making any investment, carefully read any materials you are given and verify the truth of every statement you are told about the investment. For more information about how to research an investment, read our publication Ask Questions (http://www.sec.gov/investor/pubs/sec-questions-investors-should-ask.pdf). Investigate the individuals and firms offering the investment, and check out their backgrounds on Investor.gov (https://investor.gov/) and by contacting your state securities regulator (http://www.nasaa.org/about-us/contact-us/contact-your-regulator/). Many fraudulent investment schemes involve unlicensed individuals or unregistered firms.

Additional Resources

SEC Investor Alert: Bitcoin and Other Virtual Currency-Related Investments
(https://investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-bitcoin-other-virtual-currency)

SEC Investor Alert: Ponzi Schemes Using Virtual Currencies
(http://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf)

SEC Investor Alert: Social Media and Investing – Avoiding Fraud
(http://www.sec.gov/investor/alerts/socialmediaandfraud.pdf)

The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.

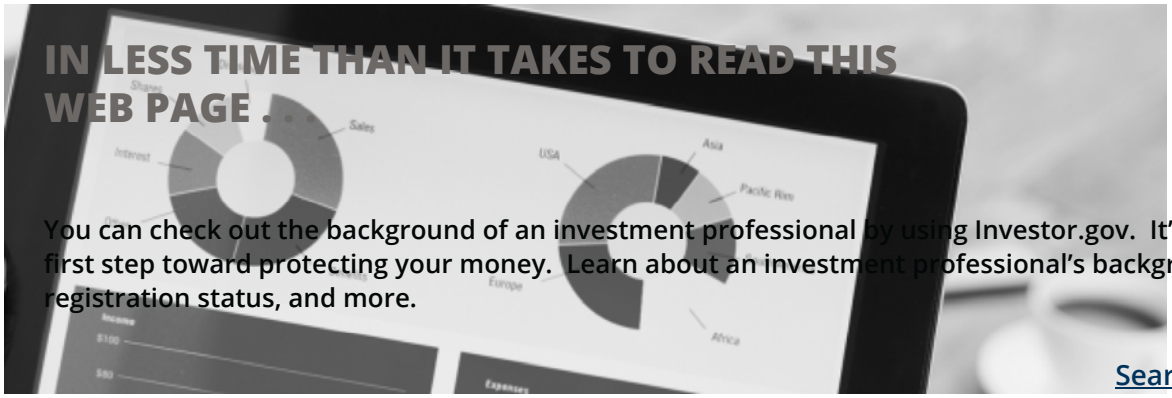

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Exhibit F

Investor.gov
U.S. SECURITIES AND EXCHANGE COMMISSION

INVESTOR ALERT: BITCOIN AND OTHER VIRTUAL CURRENCY-RELATED INVESTMENTS

05/07/2014

The SEC's Office of Investor Education and Advocacy is issuing this Investor Alert to make investors aware about the potential risks of investments involving Bitcoin and other forms of virtual currency.

The rise of Bitcoin and other virtual and digital currencies creates new concerns for investors. *A new product, technology, or innovation – such as Bitcoin – has the potential to give rise both to frauds and high-risk investment opportunities.* Potential investors can be easily enticed with the promise of high returns in a new investment space and also may be less skeptical when assessing something novel, new and cutting-edge.

We previously issued an Investor Alert (http://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf) about the use of Bitcoin in the context of a Ponzi scheme. The Financial Industry Regulatory Authority (FINRA) also recently issued an Investor Alert (http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/P456458) cautioning investors about the risks of buying and using digital currency such as Bitcoin. In addition, the North American Securities Administrators Association (NASAA) included digital currency on its list (http://www.nasaa.org/3752/top-investor-threats/) of the top 10 threats to investors for 2013.

What is Bitcoin?

Bitcoin has been described as a decentralized, peer-to-peer virtual currency that is used like money – it can be exchanged for traditional currencies such as the U.S. dollar, or used to purchase goods or services, usually online. *Unlike traditional currencies, Bitcoin operates without central authority or banks and is not backed by any government.*

> **IRS treats Bitcoin as property.** The IRS recently issued guidance (http://www.irs.gov/uac/Newsroom/IRS-Virtual-Currency-Guidance) stating that it will treat virtual currencies, such as Bitcoin, as property for federal tax purposes. As a result, general tax principles that apply to property transactions apply to transactions using virtual currency

If you are thinking about investing in a Bitcoin-related opportunity, here are some things you should consider.

Investments involving Bitcoin may have a heightened risk of fraud.

Innovations and new technologies are often used by fraudsters to perpetrate fraudulent investment schemes. *Fraudsters may entice investors by touting a Bitcoin investment "opportunity" as a way to get into this cutting-edge space, promising or guaranteeing high investment returns.* Investors may find these investment pitches hard to resist.

> **Bitcoin Ponzi scheme.** In July 2013, the SEC charged an individual for an alleged Bitcoin-related Ponzi scheme in *SEC v. Shavers* (http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539730583#.Ue6yZODmp-I). The defendant advertised a Bitcoin "investment opportunity" in an online Bitcoin forum, promising investors up to 7% interest per week and that the invested funds would be used for Bitcoin activities. Instead, the defendant allegedly used bitcoins from new investors to pay existing investors and to pay his personal expenses.

As with any investment, be careful if you spot any of these potential warning signs of investment fraud:

- **"Guaranteed" high investment returns.** There is no such thing as guaranteed high investment returns. Be wary of anyone who promises that you will receive a high rate of return on your investment, with little or no risk.

- **Unsolicited offers.** An unsolicited sales pitch may be part of a fraudulent investment scheme. Exercise extreme caution if you receive an unsolicited communication – meaning you didn't ask for it and don't know the sender – about an investment opportunity.

- **Unlicensed sellers.** Federal and state securities laws require investment professionals and their firms who offer and sell investments to be licensed or registered. Many fraudulent investment schemes involve unlicensed individuals or unregistered firms. Check license and registration status by searching the SEC's Investment Adviser Public Disclosure (IAPD) (http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx) website or FINRA's BrokerCheck (http://brokercheck.finra.org/Search/Search.aspx) website.

- **No net worth or income requirements**. The federal securities laws require securities offerings to be registered with the SEC unless an exemption from registration applies. Most registration exemptions require that investors are accredited investors (http://www.sec.gov/answers/accred.htm). Be highly suspicious of private (*i.e.,* unregistered) investment opportunities that do not ask about your net worth or income.

- **Sounds too good to be true.** If the investment sounds too good to be true, it probably is. Remember that investments providing higher returns typically involve more risk.

- **Pressure to buy RIGHT NOW.** Fraudsters may try to create a false sense of urgency to get in on the investment. Take your time researching an investment opportunity before handing over your money.

Bitcoin users may be targets for fraudulent or high-risk investment schemes.

Both fraudsters and promoters of high-risk investment schemes may target Bitcoin users. The exchange rate of U.S. dollars to bitcoins has fluctuated dramatically since the first bitcoins were

created. As the exchange rate of Bitcoin is significantly higher today, many early adopters of Bitcoin may have experienced an unexpected increase in wealth, making them attractive targets for fraudsters as well as promoters of high-risk investment opportunities.

Fraudsters target any group they think they can convince to trust them. Scam artists may take advantage of Bitcoin users' vested interest in the success of Bitcoin to lure these users into Bitcoin-related investment schemes. The fraudsters may be (or pretend to be) Bitcoin users themselves. Similarly, promoters may find Bitcoin users to be a receptive audience for legitimate but high-risk investment opportunities. Fraudsters and promoters may solicit investors through forums and online sites frequented by members of the Bitcoin community.

Bitcoins for oil and gas. The Texas Securities Commissioner recently (http://www.ssb.state.tx.us/News/Press_Release/03-11-14_press.php) entered an emergency cease and desist order against a Texas oil and gas exploration company, which claims it is the first company in the industry to accept bitcoins from investors, for intentionally failing to disclose material facts to investors including "the nature of the risks associated with the use of Bitcoin to purchase working interests" in wells. The company advertised working interests in wells in West Texas, both at a recent Bitcoin conference and through social media and a web page, according to the emergency order.

Bitcoin trading suspension. In February 2014, the SEC suspended (http://www.sec.gov/litigation/suspensions/2014/34-71568.pdf) trading in the securities of Imogo Mobile Technologies because of questions about the accuracy and adequacy of publicly disseminated information about the company's business, revenue and assets. Shortly before the suspension, the company announced that it was developing a mobile Bitcoin platform, which resulted in significant movement in the trading price of the company's securities.

Using Bitcoin may limit your recovery in the event of fraud or theft.

If fraud or theft results in you or your investment losing bitcoins, you may have limited recovery options. Third-party wallet services, payment processors and Bitcoin exchanges that play important roles in the use of bitcoins may be unregulated or operating unlawfully.

Law enforcement officials may face particular challenges (http://www.hsgac.senate.gov/download/?id=ac50a1af-cc98-4b04-be13-a7522ea7a70d) when investigating the illicit use of virtual currency. Such challenges may impact SEC investigations involving Bitcoin:

- **Tracing money.** Traditional financial institutions (such as banks) often are not involved with Bitcoin transactions, making it more difficult to follow the flow of money.

- **International scope.** Bitcoin transactions and users span the globe. Although the SEC regularly obtains information from abroad (such as through cross-border agreements), there may be restrictions on how the SEC can use the information and it may take more time to get the information. In some cases, the SEC may be unable to obtain information located overseas.

- **No central authority.** As there is no central authority that collects Bitcoin user information, the SEC generally must rely on other sources, such as Bitcoin exchanges or users, for this type of information.

- **Seizing or freezing bitcoins.** Law enforcement officials may have difficulty seizing or freezing illicit proceeds held in bitcoins. Bitcoin wallets are encrypted and unlike money held in a bank or brokerage account, bitcoins may not be held by a third-party custodian.

Investments involving Bitcoin present unique risks.

Consider these risks when evaluating investments involving Bitcoin:

- **Not insured.** While securities accounts at U.S. brokerage firms are often insured by the Securities Investor Protection Corporation (http://www.sec.gov/answers/sipc.htm) (SIPC) and bank accounts at U.S. banks are often insured by the Federal Deposit Insurance Corporation (FDIC), bitcoins held in a digital wallet or Bitcoin exchange currently do not have similar protections.

- **History of volatility.** The exchange rate of Bitcoin historically has been very volatile and the exchange rate of Bitcoin could drastically decline. For example, the exchange rate of Bitcoin has dropped more than 50% in a single day. Bitcoin-related investments may be affected by such volatility.

- **Government regulation.** Bitcoins are not legal tender. Federal, state or foreign governments may restrict the use and exchange of Bitcoin.

- **Security concerns.** Bitcoin exchanges may stop operating or permanently shut down due to fraud, technical glitches, hackers or malware. Bitcoins also may be stolen by hackers.

- **New and developing.** As a recent invention, Bitcoin does not have an established track record of credibility and trust. Bitcoin and other virtual currencies are evolving.

> **Recent Bitcoin exchange failure.** A Bitcoin exchange in Japan called Mt. Gox recently failed after hackers apparently stole bitcoins worth hundreds of millions of dollars from the exchange. Mt. Gox subsequently filed for bankruptcy. Many Bitcoin users participating on the exchange are left with little recourse.

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Before making any investment, carefully read any materials you are given and verify the truth of every statement you are told about the investment. For more information about how to research an investment, read our publication Ask Questions (http://www.sec.gov/investor/pubs/sec-questions-investors-should-ask.pdf). Investigate the individuals and firms offering the investment, and check out their backgrounds by searching the SEC's IAPD (http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx) website or FINRA's BrokerCheck (http://brokercheck.finra.org/Search/Search.aspx) website and by contacting your state securities regulator (http://www.nasaa.org/about-us/contact-us/contact-your-regulator/).

Additional Resources

SEC Investor Alert: Ponzi Schemes Using Virtual Currencies (http://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf)
SEC Investor Alert: Social Media and Investing – Avoiding Fraud (http://www.sec.gov/investor/alerts/socialmediaandfraud.pdf)
SEC Investor Alert: Private Oil and Gas Offerings (http://www.sec.gov/investor/alerts/ia_oilgas.pdf)
SEC Investor Bulletin: Affinity Fraud (http://www.sec.gov/investor/alerts/affinityfraud.pdf)
FINRA Investor Alert: Bitcoin: More Than a Bit Risky (http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/P456458)
NASAA Top Investor Threats (http://www.nasaa.org/3752/top-investor-threats/)
IRS Virtual Currency Guidance (http://www.irs.gov/uac/Newsroom/IRS-Virtual-Currency-Guidance)
European Banking Authority Warning to Consumers on Virtual Currencies (http://www.eba.europa.eu/documents/10180/598344/EBA+Warning+on+Virtual+Currencies.pdf)

Contact the SEC

Submit a question (https://www.sec.gov/oiea/QuestionsAndComments.html) to the SEC or call the SEC's toll-free investor assistance line at (800) 732-0330 (dial 1-202-551-6551 if calling from outside of the United States).

Report a problem (https://www.sec.gov/complaint/question.shtml) concerning your investments or report possible securities fraud (http://www.sec.gov/complaint/tipscomplaint.shtml) to the SEC.

Stay Informed

- Visit Investor.gov (http://www.investor.gov), the SEC's website for individual investors
- Receive SEC Investor Alerts and Bulletins by email (http://www.sec.gov/news/press/subscribe_updates.htm) or RSS feed (http://www.sec.gov/rss/investor/alertsandbulletins.xml)
- Follow the Office of Investor Education and Advocacy on Twitter @SEC_Investor_Ed (https://twitter.com/SEC_Investor_Ed)
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The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.

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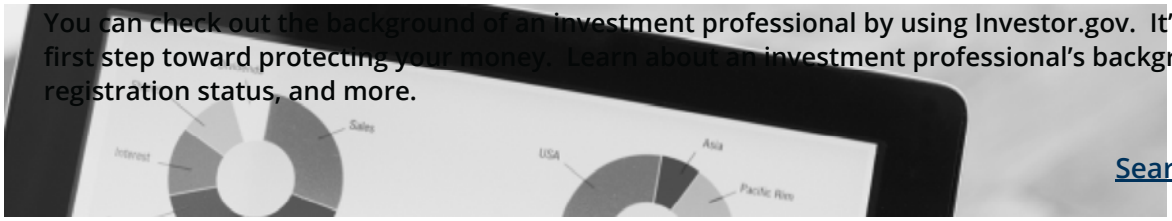
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Exhibit G

Public Statement

Statement on Potentially Unlawful Online Platforms for Trading Digital Assets

Divisions of Enforcement and Trading and Markets

March 7, 2018

Online trading platforms have become a popular way investors can buy and sell digital assets, including coins and tokens offered and sold in so-called Initial Coin Offerings ("ICOs"). The platforms often claim to give investors the ability to quickly buy and sell digital assets. Many of these platforms bring buyers and sellers together in one place and offer investors access to automated systems that display priced orders, execute trades, and provide transaction data.

A number of these platforms provide a mechanism for trading assets that meet the definition of a "security" under the federal securities laws. If a platform offers trading of digital assets that are securities and operates as an "exchange," as defined by the federal securities laws, then the platform must register with the SEC as a national securities exchange or be exempt from registration. The federal regulatory framework governing registered national securities exchanges and exempt markets is designed to protect investors and prevent against fraudulent and manipulative trading practices.

Considerations for Investors Using Online Trading Platforms

To get the protections offered by the federal securities laws and SEC oversight when trading digital assets that are securities, investors should use a platform or entity registered with the SEC, such as a national securities exchange, alternative trading system ("ATS"), or broker-dealer.

The SEC staff has concerns that many online trading platforms appear to investors as SEC-registered and regulated marketplaces when they are not. Many platforms refer to themselves as "exchanges," which can give the misimpression to investors that they are regulated or meet the regulatory standards of a national securities exchange. Although some of these platforms claim to use strict standards to pick only high-quality digital assets to trade, the SEC does not review these standards or the digital assets that the platforms select, and the so-called standards should not be equated to the listing standards of national securities exchanges. Likewise, the SEC does not review the trading protocols used by these platforms, which determine how orders interact and execute, and access to a platform's trading services may not be the same for all users. Again, investors should not assume the trading protocols meet the standards of an SEC-registered national securities exchange. Lastly, many of these platforms give the impression that they perform exchange-like functions by offering order books

with updated bid and ask pricing and data about executions on the system, but there is no reason to believe that such information has the same integrity as that provided by national securities exchanges.

In light of the foregoing, here are some questions investors should ask before they decide to trade digital assets on an online trading platform:

- Do you trade securities on this platform? If so, is the platform registered as a national securities exchange (see our link to the list below)?
- Does the platform operate as an ATS? If so, is the ATS registered as a broker-dealer and has it filed a Form ATS with the SEC (see our link to the list below)?
- Is there information in FINRA's BrokerCheck ® about any individuals or firms operating the platform?
- How does the platform select digital assets for trading?
- Who can trade on the platform?
- What are the trading protocols?
- How are prices set on the platform?
- Are platform users treated equally?
- What are the platform's fees?
- How does the platform safeguard users' trading and personally identifying information?
- What are the platform's protections against cybersecurity threats, such as hacking or intrusions?
- What other services does the platform provide? Is the platform registered with the SEC for these services?
- Does the platform hold users' assets? If so, how are these assets safeguarded?

Resources for Investors

Investor.gov Spotlight on Initial Coin Offerings and Digital Assets

Chairman Jay Clayton Statement on Cryptocurrencies and Initial Coin Offerings

Chairman Jay Clayton's Testimony on Virtual Currencies: The Roles of the SEC and CFTC

Report of Investigation Pursuant to Section 21(a) of the Securities and Exchange Act of 1934: The DAO

Investors can find a list of SEC-registered national securities exchanges here: List of Active National Securities Exchanges

Investors can find a list of ATSs that have filed a Form ATS with the SEC here: List of Active Alternative Trading Systems

Considerations for Market Participants Operating Online Trading Platforms

A platform that trades securities and operates as an "exchange," as defined by the federal securities laws, must register as a national securities exchange or operate under an exemption from registration,

such as the exemption provided for ATSs under SEC Regulation ATS. An SEC-registered national securities exchange must, among other things, have rules designed to prevent fraudulent and manipulative acts and practices. Additionally, as a self-regulatory organization ("SRO"), an SEC-registered national securities exchange must have rules and procedures governing the discipline of its members and persons associated with its members, and enforce compliance by its members and persons associated with its members with the federal securities laws and the rules of the exchange. Further, a national securities exchange must itself comply with the federal securities laws and must file its rules with the Commission.

An entity seeking to operate as an ATS is also subject to regulatory requirements, including registering with the SEC as a broker-dealer and becoming a member of an SRO. Registration as a broker-dealer subjects the ATS to a host of regulatory requirements, such as the requirement to have reasonable policies and procedures to prevent the misuse of material non-public information, books and records requirements, and financial responsibility rules, including, as applicable, requirements concerning the safeguarding and custody of customer funds and securities. The overlay of SRO membership imposes further regulatory requirements and oversight. An ATS must comply with the federal securities laws and its SRO's rules, and file a Form ATS with the SEC.

Some online trading platforms may not meet the definition of an exchange under the federal securities laws, but directly or indirectly offer trading or other services related to digital assets that are securities. For example, some platforms offer digital wallet services (to hold or store digital assets) or transact in digital assets that are securities. These and other services offered by platforms may trigger other registration requirements under the federal securities laws, including broker-dealer, transfer agent, or clearing agency registration, among other things. In addition, a platform that offers digital assets that are securities may be participating in the unregistered offer and sale of securities if those securities are not registered or exempt from registration.

In advancing the SEC's mission to protect investors, the SEC staff will continue to focus on platforms that offer trading of digital assets and their compliance with the federal securities laws.

Consultation with Securities Counsel and the SEC Staff

We encourage market participants who are employing new technologies to develop trading platforms to consult with legal counsel to aid in their analysis of federal securities law issues and to contact SEC staff, as needed, for assistance in analyzing the application of the federal securities laws.In particular, staff providing assistance on these matters can be reached at FinTech@sec.gov.

Resources for Market Participants

Regulation of Exchanges and Alternative Trading Systems

Select Commission Enforcement Actions

SEC v. Jon E. Montroll and Bitfunder

In re BTC Trading, Corp. and Ethan Burnside.

SEC v. REcoin Group Foundation, LLC et al.

SEC v. PlexCorps et al.

In re Munchee, Inc.

SEC v. AriseBank et al.

GOODWIN

Digital Currency + Blockchain Technolgy Perspecitves

April 2019

SEC'S TURNKEY JET NO-ACTION LETTER INDICATES BASELINE FOR UTILITY TOKENS

On Apr. 3, 2019, the SEC Division of Corporation Finance ("Division") issued a **no-action letter** to TurnKey Jet, Inc. ("TKJ") in response to TKJ's **incoming letter** dated Apr. 2, 2019. At the same time, the Division released a paper entitled "Framework for 'Investment Contract' Analysis of Digital Assets" (see accompanying **Goodwin Blog article**). The letter from TKJ described a program in which TKJ, a licensed US air carrier and air taxi operator providing interstate air charter services, proposed to offer and sell blockchain-based digital assets in the form of "tokenized" jet cards ("Tokens"). Consumers of air charter services ("Consumers") would be able to use the Tokens to purchase such services from TKJ, third-party carriers ("Carriers") and brokers of charter flights ("Brokers"). In the no-action letter, the Division confirmed it would not recommend enforcement action to the Commission if, in reliance on the opinion of TKJ's counsel that the Tokens are not securities, TKJ sells the Tokens without registration under the Securities Act of 1933 and the Securities Exchange Act of 1934. The Division took particular note of the following facts (taken verbatim from the Division's letter):

- 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 at 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 Token is marketed in a manner that emphasizes the functionality of the Token, and not the potential for the increase in the market value of the Token.

The no-action letter to TKJ indicates that the Division will recognize at least some token programs as not involving a security but, given the fairly straight-forward circumstances of the token program at issue, it sets a low baseline. If TKJ had established the same program ten years ago with a system of credits but without using blockchain technology or the word "token," experienced securities attorneys would not have thought they were offering securities.
We don't know how much the TKJ facts were dictated by Division demands during the pre-letter discussion period, but we have the following observations and questions about a few of the factors

that the Division cited as important to their decision in taking a no-action position:

1. Use of Funds from Token Sales. When Consumers use Tokens, the funds are applied by TKJ, a Broker or a Carrier to provide services. Once the Token is "spent" to buy jet services from TKJ, TKJ should be free to use the money to further develop the Platform, Network or App as it sees fit, including expanding functionality. If imposed by the Division, this seems to be an overprotective approach imposed to ensure that funds used to buy Tokens do not constitute an investment in the design, implementation or upgrade of the Platform. If the Platform is in fact operational, we see no reason why TKJ should be limited in how it uses funds it receives in its business to make improvements to the Platform.

2. Restriction of Transfers to TKJ Wallets Only. If the Token is not a security under the *Howey* test, it shouldn't be necessary to prevent the Tokens from being transferred to and held by outside wallets. There may be perfectly good technology or cybersecurity reasons to allow Consumers to control how their Tokens are held.

3. Repurchase by TKJ Only at a Discount. As a business matter, it would not appear to make sense for TKJ to set a condition that they will repurchase Tokens only at a discount. A rational Consumer, knowing that it could not sell Tokens back at par, would have no incentive to buy more Tokens than it needed to buy the immediately contemplated jet services. If this condition was imposed by the SEC it may have been in order to make it look less as though TKJ is supporting the value of the Tokens. However, that shouldn't be necessary if Tokens are always worth one dollar of services. The price of services may go up and down with the charter jet market generally, but one Token will still buy one dollar of services at the market price at the time of use. As a result, other than in special circumstances, the value of Tokens is unlikely to go up or down for more than a brief period of time.

We hope that the Division will consider this a baseline case, but not the only set of facts that will support a conclusion that tokens are not securities.

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