QuickLaunch University Webinar Series Transcript Initial Coin Offerings (ICOs): Recent Developments and Legal Considerations for Startups

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Presented by WilmerHale Partners Glenn Luinenburg and Jennifer Zepralka

Glenn: Hello, everyone, and welcome to today's QuickLaunch University Webinar. My name is Glenn Luinenburg, and I'm a partner in the firm's Corporate Practice in Palo Alto. I'm joined by my partner, Jennifer Zepralka, who's also in the corporate group in our Washington, D.C. office and was formerly at the SEC.

Over the last few months, we've explored many different legal issues based by entrepreneurs and early-stage technology companies as they begin to build their companies. Today, we're going to discuss initial coin offering and certain considerations for startups that are considering a token offering. If you're interested in going back to listen to our previous sessions where we covered the basics of forming a company, founder equity, and more, the links to the recording are posted on our website at wilmerhalelaunch.com.

With that, let's get started. What exactly is an initial coin offering or ICO? An ICO or initial coin offering is the sale of virtual coins or tokens often as a means of raising capital or project financing by startup companies that are involved in blockchain technology. Depending on the terms of the offering, purchasers may use virtual currencies, such as Bitcoin or Ethereum, or fiat currency to purchase these coins or tokens.

Initial coin offerings, token pre-sales, which are generally known as SAFT, Simple Agreements for Future Tokens, or similar types of sales of virtual-based coins and tokens, are quickly becoming an important fundraising tool for many early-stage companies. After the tokens or coins are generated, they can also be traded on public coin exchanges.

Let's talk a little bit about the rise in initial coin offerings. You can see to the right here the tremendous growth in initial coin offerings since 2006. Specifically, there've been over 250 blockchain startups that have closed ICOs for over $2 billion during this time period. By contrast, early-stage traditional equity investment in blockchain companies, specifically by venture capitalists and other corporate investors, was $73 million in the third quarter of 2017, which represented only 7 financing rounds, which is one of the lowest points since 2013.

By contrast, over 150 companies raised an estimated $1.3 billion by initial coin offerings in the third quarter of 2017. Year-to-date, ICOs have raised more than $2 billion with core development and blockchain governance platform, Tezos, claiming the largest ICO at around $230 million. And, most recently, Filecoin had distributed file storage platform close to second largest ICO year-to-date with about $210 million token fail in the third quarter of 2017. We've been seeing ICO token sales doubling on a monthly basis.

If you compare the amount of funds raised by initial coin offerings in the third quarter of 2017 against all tech angel and seed deals, they're almost on par at this point. All tech angel and seed deals totaled $1.4 billion in third quarter 2017 with more than 1,600 deals in that quarter, and, as I said previously, about 150 companies raised an estimated $1.3 billion using ICOs in the third quarter of 2017.

Let's take a few minutes to figure out how this all works. It all starts with understanding cryptocurrencies. Cryptocurrencies like Bitcoin and Ethereum are digital currencies created and

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regulated in terms of currency creation by encryption techniques. Think of it as a digital asset which is created and disseminated using cryptography. Cryptocurrencies are typically implemented using distributed ledgers or blockchain technology.

A virtual currency is somewhat different than a virtual token or coin, as it's really a digital representation of value that can be digitally traded and really functions as a medium of exchange, a unit of account, or some sort of store of value. In a sense, it's very simple. You solve the code to unlock the currency which then can be used to buy and sell goods and services or exchange for U.S. dollars or any other fiat currency. Where initial coin offerings enter the picture is when a startup creates a new cryptocurrency that people typically buy with the more common and established Bitcoin and Ethereum.

Even though an ICO raises funds, the coins are not typical currency. Instead, the coins or tokens purchased in an initial coin offering can be used to transfer value within the new coin's ecosystem or to other cryptocurrencies' ecosystems. In other words, virtual tokens or coins may represent other rights or functions as well. It may give the holder a right to purchase the startup's products or services, for example.

Not unlike a Kickstarter campaign, an initial coin offering typically sets a minimum goal for a fundraise and a period of time to reach that goal. If the requirements are met, then the tokens are distributed and can be used for the purchase of certain products or services developed or to be developed by the startup.

Let's consider the initial coin offering of a company called Storj. Storj is a system for decentralized file storage. Like Bitcoin or Ethereum, there's no central operator of the network. Storj raised initial funds of Bitcoin through a crowdfund of their token Storjcoin.

Storjcoin allows you to buy storage space on the Storj network, and you can earn Storjcoin if you contribute your own computer's storage to the network. If you buy or earn Storjcoin, you can purchase storage on the network, or you can hold them if you think that they'll go up in value, or you can convert them to your local currency, or Bitcoin, or Ethereum.

Most investors, however, seem to be simply holding for a jump in the price of the new currency, much as we've seen from the rise of Bitcoin and Ethereum, the two established players. If you bought $100 of Bitcoin on January 1st, 2011, it'd be worth over $1.7 million today. Individuals typically choose to invest in ICOs because they believe the tokens will have value either in and of themselves as a currency or because the tokens will have value on the platform itself where the platform could be created.

Starting an ICO, as I said previously, is not unlike starting a crowdfunding venture. Entrepreneurs and startups that want to launch an initial coin offering typically create a company. They build their startup to an early stage. They announce their plan to launch a token sale, and then they publish a white paper about what they intend to create, how they intend to do it, and how much money they're going to need to make it happen.

They then launch their new cryptocurrency using a service like CoinList or Waves. Like an initial public offering, the tokens are typically sold at a fixed price by the startup, and then they're traded on exchanges after the issuance. Laws of supply and demand determine the price on the exchanges after the initial issuance.

It all seems like ridiculously easy money and even perhaps a bit scammy to create new virtual tokens, and there've been several ICO scams today, and those have somewhat tarnished the image of the virtual token process. Clearly, the better ICOs are well-backed with strong teams and have a viable business underlying the token. The scams to date have raised the attention of the SEC, and because of that, they recently provided some guidance.

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At this point, I'm going to hand the presentation over to Jennifer, who can cover the report of investigation relating to the DAO, which the SEC released in July earlier this year. Jennifer?

Jennifer: Thanks, Glenn. That was great. Building on that really good explanation of what an ICO is, let's spend some time talking about the regulatory landscape, particularly the SEC's current position on initial coin offerings. For anyone who's been following this space, you'll know that the SEC did not weigh in on whether an ICO could be a securities offering for some time that this market got off the ground, which led to a fair amount of speculation, and uncertainty, and securities players guessing what they're going to do.

However, this summer, the SEC put out a report, as Glenn just mentioned, that shed some light on the commission, that the report in July, which isthe report of investigation of an offering of digital tokens by the DAO. We're going to talk about the report in some detail. We're not going to go into every detail of it, but it is important to understand where the SEC is coming from.

The punchline is that that report makes it clear that the SEC's view is that the traditional securities law analysis applies to new technologies. We all want to change the world. In the SEC's view, it doesn't matter if you're using a new technology. If you're selling something that has the characteristics of a security, it is going to be subject to the SEC's jurisdiction.

It's important to know that the SEC did not say that every initial coin offering is a securities offering. We're going to come back to that in a bit, because that is key. But, it is also extremely significant that the SEC has very publicly taken the position through this report that at least some of these initial coin offerings are going to be securities offerings.

Now, why does that matter? We have to start with one of the first essential principles of securities regulation going back to 1933, which is that any offering sale of securities must be registered under the Securities Act or conducted under an exemption from that registration requirement. That's Section 5 of the '33 Act, you'll hear people talk about that, and it's key here to what we're dealing with.

Here, for this slide, what we're talking about is an initial coin offering that involves securities. Again, as we'll stress in a bit, not all ICO is going to involve securities, but if it does have securities involved or if there's a, you know, pretty big question where there are securities involved, then we have to worry about the SEC.

If a securities ICO is not registered with the SEC and it does not meet the requirements of an exemption from registration, then that would be an illegal securities offering. I don't believe anyone has tried to register one of these offerings yet. The issuer or the people involved in promoting that offering could face serious civil or criminal liability.

This is serious stuff. The consequences of a violation could be major fines, penalties, order to cease and desist that could essentially put a company out of business, potential liability for the individuals running the company or involved in the offering. Plus, because we're talking about Section 5 of the Securities Act, there's a remedy right there in that law that says that the purchasers of the securities also would have the right under the act to force the seller to resend the transaction, which means that the seller would be required to repurchase the securities, the tokens at their original purchase price plus interest, which would obviously be a big business problem for most startups. We'll discuss again a little later that, if the tokens are securities and are being traded on exchanges, the activities of those exchanges or other intermediaries involved in the trading would also come under scrutiny. You don't want to run afoul of the federal securities laws.

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Now that I've scared you, we're talking about all the bad things that can happen. Let's look at what the SEC actually said or considered important when it was looking at the DAO offering. We'll spend a little time on the background. In 2016, the DAO, which was a virtual entity, offered and sold approximately 1.15 billion DAO tokens in exchange for a total of approximately 12 million Ether, was converted to about $150 million at that time. Investors in these tokens could hold the tokens as an investment with certain voting and ownership rights, or they could sell them on secondary market platforms.

The tokens were promoted and sold through a website that described the DAO's purpose as being, "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."

That quote's not actually all that important to the securities law analysis, but I like to read it out loud, because it's still poetic. More importantly for the securities law analysis is the point in the promotional materials that the DAO would earn profits by funding projects that would provide DAO token holders with a return on their investment. That is something that is key to the analysis that we're talking about right now.

There were no limitations placed on the number of DAO tokens offered for sale, the number of purchasers who could participate, who those purchases were, whether they needed to be sophisticated or not, and there were no limits on the ability to resell the tokens. The DAO, in marketing this offering, represented that the tokens would be available for secondary market trading and the tokens were freely tradable on the Ethereum blockchain and could be redeemed for Ethereum pretty freely.

Following the offering, between May and September, the tokens were sold on a number of different platforms. There was an issue in June of 2016 where someone was able to exploit a flaw in the code and stole approximately one-third of the DAO's assets. This may have been part of why this particular offering came to the SEC's attention, but that's not clear from the report. That's just speculation on my part. Following that, the DAO did take steps to revive its protocol going forward just to try to avoid future losses.

That's our fact pattern as set out by the SEC in the report. The SEC took that fact pattern and applied some longstanding law to determine whether the DAO tokens were securities, and that's even described on the slide. Both the '33 Act and the '34 Act included two main, you know, federal securities laws. They both have a definition of the term "security" that encompasses a wide variety of instruments, things, you know, that we all think of as securities stock, notes, plus also something called an investment contract.

There's a “facts and circumstances” test set forth by the U.S. Supreme Court in a case called SEC versus W. J. Howey Company that had long been applied to determine whether a particular instrument should be considered an investment contract and therefore a security. You will hear lots of people talking about the Howey test. If you're considering anything in the ICO space, that's the main piece of law that you're going to hear being talked about.

Interestingly, we’re applying a Supreme Court case from 1946, quite a long time ago, to a brand new technology. The elements to be considered when you're applying the Howey test to an instrument like a new token are whether the purchasers of the instrument invested money in a common enterprise with a reasonable expectation of earning profits derived from the efforts of others. That's the framework.

There's four prongs to the test, and this is the test that we, securities lawyers, have been applying for a long time to a variety of instruments, everything from orange groves, to payphones, and now to tokens, and that's the test you use to determine whether these types of things will be treated as securities. And this is the test that in their report on the DAO the SEC made very clear is what they think should be

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applied to token and initial coin offerings to determine whether they're securities and therefore subjected to the securities laws.

Let's break that down. The SEC easily found that three of the four elements of the Howey test were met, that is if the payments which were made in Ethereum would be considered an investment of money and that the investors in the DAO were investing in a common enterprise, they couldn't have done this alone, and had a reasonable expectation of profit in light of the stated objective of the DAO, which I noted earlier, which was to fund projects in exchange for a return on investment, and the token holders were expecting to share in those potential profits.

The fourth prong of the test took a bit more writing on the SEC's part in the report, and they did discuss in detail the application of the fourth element of the test, which is the requirement that the investors have an expectation that the profits would be derived from the efforts of others, the efforts of others prong. The key to the SEC's analysis here when they looked at the DAO was the significant reliance that the DAO investors placed on the managerial and entrepreneurial efforts of the founders and curators of the DAO. SEC also noted that those token holders had only limited voting rights and access to information. They're essentially passive, letting others, run things in a way that these token holders expected their profits to arise.

At the end of the day, seen through the lens of the Howey test, and particularly for those of us who spend a lot of time with the securities laws, we were not particularly surprised that the SEC found a security to exist in the DAO offering. That may have been what made this one a good candidate for the SEC to put out their report and lay out the analysis, which is very helpful.

What does the DAO report mean for ICOs going forward? As I mentioned before, probably the most notable element of the report was the fact that the SEC did not say that all tokens are or are not securities. Rather, it set it up that those determinations should be made on a case-by-case basis, and the report stresses the importance of a detailed analysis of the fact and circumstances of the particular offering, which is helpful. It helps to know that the SEC will definitively apply the Howey test, because that makes it possible for an issuer of tokens to try to structure the offering in a way that will avoid characterization as a security.

Now, that is more easily said than done, but it means that it is possible. For example, tokens that are linked to the use of a particular product or service, not marketed for their investment potential, but rather intended to be a medium of exchange for access to a platform or a service is almost your ticket to entry onto some service that the company is providing would not seem likely to satisfy the expectation of the profits element of the Howey test. And, therefore, we see types of tokens which are now often being referred to as utility tokens, may be able to avoid being considered securities if you're careful about how you structure them.

Conversely, it may not always be possible to get entirely comfortable that no security is involved. Even if you are trying to create a utility token, there may be enough gray area that you're just not entirely there, or it could be that for business reasons there are characteristics that you want to build in to your token that make it more security-like. In that case, the issuers of such tokens may wish to consider structuring their offering to comply with the U.S. federal securities laws.

There are a few ways to go about this. The first is the possibility of registration, registering the offering with the SEC. This would not be an easy or an inexpensive process. It would probably be quite complicated, but senior staff members at the SEC have recently indicated that they would be open to the possibility of a registered ICO. Or, as an alternative, you would look for an exemption from the registration requirements that you could fit your offering within.

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Regulation D is probably the most likely candidate. That's the most commonly used private placement exemption for securities offerings, and that would be available if the issuer of the tokens were willing to limit purchasers of the tokens to accredited investors, which are investors with $200,000 of income or $1 million net worth, not counting your house. It's not the most democratic way of doing an offering, but there are lots of people who qualify as accredited investors out there.

You'd limit the purchasers to those accredited investors and meet the other requirements of the rule, which includes taking reasonable steps to verify that those purchasers are accredited investors, which is a little bit of an administrative burden. There are third parties out there that are providing this service to ICO issuers as well as to traditional securities issuers to conduct that necessary verification that could smooth the process.

Some issuers may also try to comply with Regulation S, which is the exemption for offshore offerings. That won't necessarily work for a company that even if based offshore is selling their tokens in the United States to U.S. persons and also will not necessary work if you incorporated another jurisdiction, but, you know, your team of people who are running the company are actually still sitting in the United States, but it's something that could work for certain companies.

Other exemptions also have some potential, such as Regulation A. There are pros and cons to the different approaches. If you could manage, you should do a registered initial coin offering. As I mentioned, this could take a fair amount of time and money, but after doing so, those tokens could be offered to any type of investor and could trade freely on the exchanges right away afterwards.

Conversely, if you had a Regulation D-exempt initial coin offering, that would be far less expensive and time-consuming, but there are some restrictions that come along with that on who can purchase, how you comply with the rule and restrictions on tradability that you would not be able to make those tokens immediately tradable on the exchanges. And then, of course, with any securities offering, registered or exempt, there's liability that the issuer would be taking on forcompliance with the rules and particularly for liability for any faults or maybe misleading statements in the disclosures that are made to the investors. There could also be questions about how the state securities law regulations apply.

Before I move off the idea of how you comply with the federal securities laws, I want to just raise the concept of a SAFT, which Glenn also mentioned at the beginning of the webinar, something that's come up around the issue of pre-sales of tokens. We've just spent some time on the Howey test. When you work through the Howey test for a token that is in pre-sale prior to the platform or service that the token would be a utility token for, I have some concerns over how you fit such a pre-sale token within that analysis and get entirely comfortable that it won't be treated as a security. I'm sure it's possible. There are many, many permutations of these things, but it's just something that seems quite unclear.

Some smart people out there came up with the idea of a SAFT, which builds on an instrument that has existed for a while known as a SAFE, which stands for a Simple Agreement for Future Equity, that some startups have been using for capital raising, issuing this instrument before they're ready to issue equity in their company. This is a staff to the Simple Agreement for a Future Token, and it's the same kind of idea that you would be selling the SAFT while you're in the stage, while you're building out your platform and getting ready to issue the tokens.

The buyer of the SAFT buys the SAFT itself as the instrument which entitled him or her to tokens when and if those tokens were issued. Generally, SAFT should be treated like securities under that Howey analysis that we talked about, and typically what we've seen is that they're offered in holding compliance with the securities laws, usually Regulation D offering to accredited investors.

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The SAFT then when the tokens were issued would convert into the tokens, and those could be securities tokens or utility tokens, which raises some questions.I'm going to raise questions without necessarily giving you answers, but questions around the line drawing for utility token. When does that token really have the utility that you can say that someone is buying and not for investment purposes, but for use as a method of accessing a product or a service? If you're selling it as a SAFT, first, in connection with the SAFT, it might be a security up until it's a fully usableutility token, but what's fully usable is that if you're in test mode, is that good enough, do you have to wait until it's fully launched? If your platform is constantly evolving, when do you ever say that something is fully launched? We don't know the answers here yet, and it may take a while to play out and get more guidance from the SEC on how they will apply these principles moving forward.

Just moving on from that briefly, another issue that we don't know all the answers to yet is what all of this means for the exchanges that are out there, lots of exchanges. The SEC's report stressed the need for compliance with the requirements under the Exchange Act for registration of the exchanges. If at least some of the tokens that are out there are securities, then it would follow that at least some of the exchanges are trading them without complying with the federal securities laws. I've heard that there's been an effort on the part of many of these exchanges to put processes in place that they're not running afoul of the securities laws, but I think it's likely that the SEC will be weighing in here in this space again.

Thanks for bearing with me on all that gloom and doom about the SEC’s angle on this. There's a lot here, and I think you can tell there are still a lot of open questions and uncertainties around how the SEC will regulate this going forward. There will still be developments as we go. I see other definitions are still going to be appropriate for some companies, but there's no well-worn path yet. I think we would say, be careful as you move forward on these, but we will be watching.

Now I'm going to turn it back to Glenn to talk about yet more of the gray areas that we're grappling with in the context of initial coin offering.

Glenn: Thank you, Jennifer. I'm going to cover some of the other regulatory questions that are outstanding. The first question is whether or not the tokens will be subject to regulation by the CFTC under laws applicable to trading of commodities? In other words, can SAFTs be swaps?

A swap is an agreement in which one party pays cash and the other party delivers cash, securities, or other consideration in an amount based on the economic performance of a specific security or other assets. Although the CFTC has not yet issued official guidance, we currently believe that most SAFTs should properly be treated as forward purchase agreements rather than swaps.

This becomes significant because these SAFTs are in fact swaps. They can only be generally purchased by investors with $10 million in assets, which is considerably higher than the $1 million net worth test for accredited investors under federal securities laws that Jennifer just outlined.

The next issue that I want to address is whether or not state money transmitter laws or the federal regime for money services businesses applies to tokens. Now, we currently believe that most token sponsors do not trigger state money transmitter laws or become a federal money services business or MSB in short form by issuing tokens. Platforms and trading systems that facilitate the sale and transfer of tokens, however, may in fact trigger MSB and money transmitter laws, which generally impose among other things strict anti-money laundering rules, customer identification, and know your customer requirements.

The next regulatory issue I want cover is whether or no the New York State BitLicense applies to the issuer of tokens. These regulations, which only New York at this point has adopted, imposed a

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significant registration and compliance scheme on entities that issue virtual currency from or in the state of New York. Virtual currency is extensively defined to include digital stores of value, which could apply to many tokens. The most conservative approach here would be to not offer tokens from New York or to New York residents until the state clarifies whether it intends for the token issuers to become subject to its BitLicense requirements.

The last issue that I wanted to cover was how other countries apply their securities laws to tokens, or regulatory issues outside of the United States. China recently banned ICOs, at least for now, by declaring ICOs to be an illegal fundraising tool, and the country has indicated that its reviewing previous initial coin offerings or possible fraudulent practices. Canada is taking a similar approach to the U.S., a fact and circumstances analysis, to determine whether or not the token is a security and would be subject to Canadian securities laws.

Malaysia, Singapore, Thailand, and Russia have also issued guidance and warnings on the legality of ICOs in their countries. While certain foreign countries are widely viewed as providing less restrictive regulatory environments for token than the regulatory environment of the U.S., in many countries at this point, it may be too early to tell whether this position is fully justified. The bottom line is token issuers should carefully consider local law when offering in jurisdictions outside of the United States.

Jennifer and I will sum up our conclusions now. Clearly, some tokens are and always will be viewed as securities. Tokens that offer holders dividend, interest, or profit, or revenue participations, for example, would always be securities. And, as Jennifer noted, tokens that are issued before they can even be generally used, often an initial coin offering, is a form of project-based financing to fund a particular product. Even if the ultimate token is a utility token on that particular platform, to the extent that the platform is still being built and that the value of the token that's issued is typically dependent upon the sponsor of the tokens to develop and market the tokens and the platform in which the tokens will be used, this is going to capture the reliance of others prong of the Howey test, and it's the hallmark of determining when an instrument like a token is a security.

You have to be very, very careful when structuring a token offering and applying the Howey test.

Jennifer: I'm sure that everyone listening in is wishing that we could give them more specific guidance on what exactly makes something a utility token versus a security. Unfortunately, that is because it is such a fact and circumstances analysis, and I think everything that Glenn just summarized about, you know, when you're still on the building up stage, I think that's very important. As you're working on these, if you're considering issuing tokens, it really is you that needs to go through every aspect of the token sale and look at how it fits within that Howey analysis. It's not easy, but it's worth doing to avoid some of these regulatory pitfalls that we've identified.

Glenn: At this point, we're going to open it up to questions. We have about 15 minutes left in the presentation. We did receive a number of questions up front, and we'll address some of those at this point. The first question we'd like to address is, why is an initial coin offering different than other fundraising methods? Is it possible to use traditional fundraising methods after deciding to engage in an ICO? And, lastly, how do funds show on the balance sheet?

Jennifer: I think one very fundamental difference between an ICO and a more traditional funding round is that the investors in an ICO are not taking an equity stake or a debt position in the company. It's a new animal that I think investors are considering what exactly it is that they're buying and how it relates to the business, particularly if it's styled as a utility token where you're not participating in the profits of the company, what the investor is purchasing is really sort of just that utility, the ability to use the token and then, related to that, the ability to resell it at some point later.

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Glenn: I think that's a really good point, and it relates to the second half of the question as to how the funds show on the company's financial statements. I know that most direct sales of tokens, to the extent that utility tokens generate taxable income for the token issuer, as opposed to traditional equity, which shows up as stockholders equity on the balance sheet, a utility token is going to generate taxable income for the token issuer.

We believe that an issuer may actually defer a portion of this income from the sale if it's done as a pre-sale; if it's done as a SAFT for up to one year. If the purchaser of the SAFT receives some or all of the tokens deliverable under the SAFT in one or more years following the year that SAFT is issued and the deferred amount is recognized as deferred income on the company's balance sheet under applicable financial accounting rules under GAAP, we're not really that confident that the internal revenue service will respect any deferrals for more than one year.

We’ve had some questions about whether setting up an offshore entity under the British Virgin Islands, or the Cayman Islands, or a more tax-friendly jurisdiction, would alleviate some of the securities laws concerns that Jennifer has outlined. Jennifer, do you want to take a stab at that one, and then I'll add points on it as well?

Jennifer: Sure. I mentioned the idea of Regulation F, so sort of a couple things to think about in the framework, right? If we are talking about a token that we can all get a bit comfortable is a utility token and therefore not a security, then that's sort of not too much of a problem here under the U.S. laws, although you would still need to look at all those country local laws that Glenn just went through, China, Canada, Singapore. Various regulators around the world are weighing in on whether they want to regulate tokens, and whether or not they would be securities.

For U.S. securities laws purposes, if you're not selling tokens to U.S. persons, you probably don't need to worry about it too much. I would hesitate to say that if you're a U.S. company selling your tokens entirely offshore that you wouldn't have to worry about the SEC jurisdiction there as well, because you're sitting in the United States telling them. I don't think that's a common fact pattern, but perhaps it is.

Glenn: I'll build on that. From my perspective, using an offshore entity to issue the tokens certainly doesn't change the applicability of the securities laws to tokens being offered and sold in the U.S. Tokens that are securities, as Jennifer noted, may only be sold in the U.S. by the issuer if the tokens are either registered with the SEC or they're sold in a transaction that's exempt from registration under Reg B or Reg S as we've talked about.

This is true regardless of where the issuer of the tokens is located. Most token sales in the U.S. are exempt from registration, because they're sold in private placement solely to accredited investors as we've talked about, but simply incorporating an offshore entity doesn't alleviate the need to comply with U.S. securities laws.

Jennifer, do you want pick the next question that we'll address?

Jennifer: I want to go back a little bit to where we started with the questions about the relationship between an ICO and more traditional funding options, because I think we have some questions aboutwhether doing an ICO now could have an impact on your ability to raise more money later.

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Again, I don't think we know anything in black and white here. But in a hypothetical situation where a company does an ICO and then later wants to do a more traditional funding round with a venture capital firm, I would be prepared to answer a fair amount of questions from that venture capital firm as they're looking at the company. That firm would want to get pretty comfortable with how you structured your ICO, how comfortable everyone is that what was sold either was not a security, or, if it was a security, that it was conducted properly under the federal securities laws. Future investorswill be cautious about investing in a company that could potentially be looking at securities law liability from an earlier initial coin offering.

Glenn: I completely agree, Jennifer. I think it will be a point of due diligence for any potential venture capital investor as to whether an initial coin offering or a token offering was done in compliance with securities laws and whether they're taking on any risk associated with the prior offering. It's interesting.

We're starting to see some of the venture capital investors now add protective provisions to traditional equity-based documents, to the certificate of incorporation, that would requirea series vote or a specific stockholder vote to permit the company to do any sort of coin or token offering in the future. That suggests to me that the venture capital community at least is viewing the offering sort of skeptically at this point and certainly wants to be involved in any decision of their portfolio companies to in fact do a coin offering in the future.

Jennifer: That's right. I know we've got some questions about what we think the SEC's next move may be, and, honestly, we don't know. There are some senior staff members at the SEC who have made some public statements pretty recently acknowledging that they have put together a team within the SEC that's keeping tabs on the ICO market and what's going on, and the director of the division of corporation finance has acknowledged that sometimes those staff members are calling up ICO issuers to ask them about their compliance andwhat thought they've given to the securities laws.

Everyone always wants to know what we think; how the SEC is deciding which companies to call up or which ones to look at. Again, it could be lots of things. Personally, I would imagine that they're looking at offerings that are of significant size and that receive a significant level of publicity as they go through the offering process. Some offerings are much more high profile than others, and the SEC staff are people, too, so they see what's in the news. But it could also be a much more systematic review. We don't really know.

We don't want to give anyone false comfort that if you don't get publicity, they won't come talk to you. I also think that, as I mentioned, the issues around the exchanges that it's likely that at some point the SEC will spend a little time looking at that issue and figure out if there's something that can be done to bring that part of the market into line with the securities laws.

Glenn: It seems to me that the token trading platforms would be the low-hanging fruit for the SEC, and by going after the token trading platforms, they could severely limit the liquidity for U.S. persons holding tokens. I know that one entity in the U.S. has already announced its intention to become a regulated as an alternative trading system or ATS and permit trading of tokens that are securities. A number of other platforms, which are often outside of the U.S., also permit U.S. citizens and residents to buy and sell tokens. If the SEC requires such a platform to register as an exchange or as an ATS, if it continues to accept U.S. purchasers, some of these platforms may seek to restrict you as persons from participating. As I said, if they really want to go after token sales, the easiest way to do it would be to go after the token trading platforms.

Jennifer: I agree.

Glenn: So, that concludes our presentation.

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Jennifer: As Glenn said, that concludes our presentation. I'm sorry we didn't get to all of your questions, but hopefully we can talk at some other time. Thank you all very much for joining us. We hope that you'll join us for our next session on December 5 where some of our colleagues are going to talk about planning for exit transactions, and you'll receive information about that topic via email in the coming week.

For those applying for CLE credit, the code word that should be entered in the attorney affirmation form is coin, C-O-I-N, very creative. If you have any additional questions about any of the topics discussed today, you can feel free to reach out to me or to Glenn. Our contact information is on the last slide in the deck, and we do thank you again for your attendance and your participation, and this was great. Thanks a lot.

Glenn: Thank you very much.

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