Essay

What Is an ICO? Defining a Security on the Blockchain

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Abstract

2017 brought the rise of the initial coin offering ("ICO"), a novel fundraising concept that enables organizations to raise funds from anyone with an internet connection and a cryptocurrency wallet by selling tokens that will have some future purpose related to the companies' products or services. But thus far, few ICOs have complied with Securities and Exchange Commission ("SEC") regulations regarding the offering of securities to outside investors despite most tokens having the characteristics of securities, which would bring them into the SEC's regulatory scope. In late 2017, the SEC began regularly enforcing registration and disclosure regulations against organizations launching ICOs, prompting many organizations to structure their ICOs such that their tokens appear to fall outside the definition of a security. But the SEC has continued its enforcement efforts, arguing that the organizations' attempts to circumvent regulatory requirements in form do not change the substance underlying the transactions.

This Essay presents an expanded argument that tokens that have no practical use when sold, which are instead sold to raise funds for the underlying organization, constitute "investment contracts" and are therefore securities. It then argues that the SEC's interpretation of securities to include tokens should

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receive Chevron *deference in courts because the definition of a security is ambiguous, and the SEC is better positioned to make interpretations that can keep up with the fast-paced evolution of blockchain-based investment products.*

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Introduction

On June 1, 2018, a Cayman Islands–based organization headquartered in Hong Kong that few have heard of, Block.one, completed its initial coin offering ("ICO").[1] It raised over $4 billion,[2] and it did so

[1] Grace Dandan, *HK Hackathon Sees Block.one Start Spending Its Billions*, Asia Times (June 12, 2018), https://www.asiatimes.com/2018/06/article/hk-hackathon-sees-block-one-start-spending-its-billions/ [https://perma.cc/P73J-Q7L6]; Lea Nonninger, *Block.one* Just Raised a $4 Billion ICO, Bus. Insider (June 4, 2018, 9:10 AM), https://www.businessinsider.com/blockone-raises-4-billion-ico-2018-6 [https://perma.cc/6HUJ-SQNP].

without having introduced a single live product.[3] For context, a $4 billion initial public offering ("IPO") would be the 19th largest of all time, somewhere between Goldman Sachs's $3.7 billion IPO and Blackstone Group's $4.1 billion IPO.[4] This may raise an obvious question: What *is* Block.one?

Block.one's website does not provide much clarification: it includes vague descriptions of the successes of its primary product, EOSIO, and the company mission "[to b]uild[] a more secure and connected world" and "provid[e] high-performance blockchain solutions" but no explanation of what it does day to day.[5] The website does, however, include a lengthy disclaimer noting in part that

> Block.one is a software company that is producing the EOSIO software as a free, open-source protocol . . . . Block.one will not be launching any of the initial public blockchains based on the EOSIO software . . . . Block.one does not guarantee that anyone will adopt or implement such features, or provide such services, or that the EOSIO software will be adopted and implemented in any way.[6]

The truth is no one quite knows what Block.one is yet.[7] Most readers who have heard of Block.one likely encountered it on *Last Week To-*

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2 Brady Dale, *The EOS Blockchain Is Now Officially Live*, CoinDesk (June 15, 2018, 12:50 PM), https://www.coindesk.com/the-eos-blockchain-is-now-live/ [https://perma.cc/K98G-JLJ5].

3 *Id.*

4 *All Time Largest U.S. IPOs*, Renaissance Cap., https://www.renaissancecapital.com/IPO-Center/Stats/Largest-US-IPOs [https://perma.cc/78US-ERJN]. Goldman Sachs has been in business since 1869, *Our Firm*, Goldman Sachs, https://www.goldmansachs.com/our-firm/index.html [https://perma.cc/M7ES-CQVZ], and Blackstone since 1985, *The Firm*, Blackstone, https://www.blackstone.com/the-firm/overview [https://perma.cc/Z4K8-W4Q5].

5 block.one, https://block.one/ [https://perma.cc/37DV-WQ8A]. Headlines include vague titles like "Block.one Launches Online Learning Toolkit Elemental Battles as an Engaging Gateway to EOSIO Blockchain Development," "How Blockchain Offers an Answer to Banks' [Know Your Customer] and [Anti-Money Laundering] Issues," "Lessons for London: How the UK can be a Global Leader in Blockchain," and "Blockchain Is a Movement." *News*, block.one, https://block.one/news/ [https://perma.cc/ND8A-V2LU].

6 *Disclaimer*, block.one, https://block.one/disclaimer/.

7 In an introductory video titled *What is Block.one?*, Block.one's chief technology officer explains that they "make [their] software free and available for anyone to use to launch their own blockchains, and we expect there'll be many blockchains," not making clear how the company intends to earn money. EOS.IO, *What is Block.one?*, YouTube (May 16, 2018), https://www.youtube.com/watch?v=sE-skx8Hfoo [https://perma.cc/H5HE-7UME]. Its CEO touts that the company will create "decentralized applications that can compete with the largest technology incumbents today" and that the company is "really at the forefront of developing the next generation of the internet." *Id.*

night with John Oliver, HBO's weekly news show, in a segment that pilloried Block.one's bizarre EOSIO marketing campaign.[8]

Despite the vagueness of the company's business prospects and the lack of any evidence of revenue, anticipated revenue, or business plan, investors snapped up EOS "tokens."[9] The tokens, instruments purchased in an ICO, are somewhat analogous to shares of stock.[10] But unlike stock, these tokens purportedly came with no rights.[11] Although buyers believed that Block.one would exchange the tokens purchased in the ICO for tokens on the EOS development platform,[12] the token purchase agreement stated explicitly that ICO tokens "are *not* tokens on the EOS Platform," suggesting that these tokens may not even have practical uses.[13]

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8 In a marketing video replayed on Oliver's show, an EOS representative made this broad assertion without describing what Block.one's business is: "Everything will be better, faster, and cheaper. Everything will be more connected. Everything will be more trustworthy. Everything will be more secure. Everything that exists is no longer going to exist in the way that it does today. Everything in this world is about to get better." *Last Week Tonight with John Oliver: Cryptocurrencies*, ep. 64 (HBO television broadcast Mar. 11, 2018); *see also* LastWeekTonight, *Cryptocurrencies: Last Week Tonight with John Oliver (HBO)*, YOUTUBE (Mar. 11, 2018), https://www.youtube.com/watch?v=g6iDZspbRMg [https://perma.cc/X9KX-UR4P].

9 Paul Vigna & Peter Rudegeair, *Investors Snap Up Coins with No Purpose*, WALL STREET J., Dec. 19, 2017, at B1 (noting that Block.one itself "describes what it is selling . . . as having 'no purpose'").

10 *See Initial Coin Offering (ICO)*, INVESTOPEDIA, https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp [https://perma.cc/G6VR-KMFT].

11 Block.one laid out the details of EOS tokens in a purchase agreement providing the following:

> The EOS Tokens do not have any rights, uses, purpose, attributes, functionalities or features, express or implied, including, without limitation, any uses, purpose, attributes, functionalities or features on the EOS Platform. Company does not guarantee and is not representing in any way to Buyer that the EOS Tokens have any rights, uses, purpose, attributes, functionalities or features.

EOS TOKEN PURCHASE AGREEMENT 2 (2017), https://d340lr3764rrcr.cloudfront.net/purchase_agreement/block.one+-+EOS+Token+Purchase+Agreement+-+September+4%2C+2017.pdf [https://perma.cc/5CRC-QB3N].

12 One writer compared the EOS platform to Google's Android platform, with developers then building independent applications within the EOS framework. Paul Vigna, *Banking & Finance: At Platform Launch, Discord on Agenda*, WALL STREET J., June 13, 2018, at B14. Tokens on the EOS platform could also be transferred to enable systems on the EOSIO platform or traded on cryptocurrency exchanges much like someone might transfer funds from one bank account to another or trade stock. Josh Kauffman, *What Does Staking and Unstaking EOS Tokens Mean?*, EOS CAN. (Aug. 22, 2018), https://www.eoscanada.com/en/what-does-staking-and-unstaking-eos-tokens-mean [https://perma.cc/JG3Y-8WRS].

13 EOS TOKEN PURCHASE AGREEMENT, *supra* note 11, at 2. Most recognize this as a legalistic ruse. *See* Daniel Bradley, *Shedding Some Light on the EOS Token ICO & Purchase Agreement*, STEEMIT (June 27, 2017), https://steemit.com/eos/@daniel2416/shedding-some-light-on-the-eos-token-ico-and-purchase-agreement [https://perma.cc/C42B-MKUE].

At this point, the uninitiated reader may be confused, but the reason for confusion is simple: ambiguities in token sales and purchase agreements result from a fear of regulation.[14] Organizations do not want their ICOs to be regulated under U.S. securities laws, and they contort themselves in knots attempting to avoid the government's scrutiny.[15]

But the Securities and Exchange Commission ("SEC") is not so easily fooled. Since the explosion in value of Bitcoin and other so-called "cryptoassets," entrepreneurs, crooks, ordinary people, and governments have studied them and sought to use the technology on which they are based, blockchain, to revolutionize nearly everything.[16] In July 2017, the SEC fired warning shots for those who conduct ICOs, publishing a report targeting a then-defunct organization funded by an ICO and concluding that its tokens were securities.[17] Two months later, the SEC stopped warning and started enforcing.[18] As of this writing, the SEC has begun at least 12 enforcement proceedings,[19] many with corresponding criminal lawsuits that will shape the SEC's enforcement strategy in this nascent field.

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14 *See* Bradley, *supra* note 13.

15 *See id.*

16 DON TAPSCOTT & ALEX TAPSCOTT, BLOCKCHAIN REVOLUTION, at xxviii (1st trade paperback ed. 2018) ("This explosion of value in cryptoassets has captured the imagination of developers, entrepreneurs, nongovernment organizations, and the media, not to mention governments, central banks, the investing public, and regulators."); *see* Naomi LaChance, *Not Just Bitcoin: Why the Blockchain Is a Seductive Technology to Many Industries*, NPR: ALL TECH CONSIDERED (May 4, 2016, 7:01 AM), https://www.npr.org/sections/alltechconsidered/2016/05/04/476597296/not-just-bitcoin-why-blockchain-is-a-seductive-technology-to-many-industries [https://perma.cc/4X5L-2P75] (noting that blockchain is "a transformative technology that institutions including the U.K. government, major banks[,] and the state of Delaware are looking to leverage").

17 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81,207, 2017 SEC LEXIS 2194 (July 25, 2017) [hereinafter The DAO Report].

18 *See* Complaint at 1, SEC v. REcoin Grp. Found., No. 17-cv-5725-RJD-RER (E.D.N.Y. Sept. 29, 2017).

19 *See* Crypto Asset Mgmt., LP, Securities Act Release No. 10,544, Investment Advisers Act Release No. 5,004, Investment Company Act Release No. 33,222, 2018 SEC LEXIS 2241 (Sept. 11, 2018); TokenLot, LLC, Securities Act Release No. 10,543, Exchange Act Release No. 84,075, Investment Company Act Release No. 33,221, 2018 SEC LEXIS 2240 (Sept. 11, 2018); Tomahawk Expl. LLC, Securities Act Release No. 10,530, Exchange Act Release No. 83,839, 2018 SEC LEXIS 1988 (Aug. 14, 2018); Munchee Inc., Securities Act Release No. 10,445, 2017 SEC LEXIS 4005 (Dec. 11, 2017); Complaint, SEC v. Blockvest, LLC, No. 18CV2287-GPC-BLM (S.D. Cal. Oct. 3, 2018), 2018 U.S. Dist. LEXIS 179424; Complaint, SEC v. Titanium Blockchain Infrastructure Servs., Inc., No. CV18-4315-DSF(JPRx) (C.D. Cal. May 22, 2018); First Amended Complaint, SEC v. Longfin Corp., 316 F. Supp. 3d 743 (S.D.N.Y. 2018) (No. 18-cv-2977-DLC); Complaint, SEC v. Sharma, No. 18-cv-2909 (S.D.N.Y. Apr. 2, 2018); Complaint,

Legislators,[20] commentators,[21] and businesses[22] have called for ICO guidance from the SEC or other federal agencies. The current landscape is chaotic—with companies touting dubious blockchain credentials launching ICOs every day and widespread ad hoc enforcement and regulation occurring at the state level,[23] the industry "urgently needs sound regulation."[24]

But much of the desired "sound regulation" already exists—securities regulation. And its enforcing body, the SEC, has used it to introduce order to this complex marketplace.[25] This Essay argues that

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SEC v. AriseBank, No. 18-cv-186-M (N.D. Tex. Jan. 25, 2018); Complaint, SEC v. PlexCorps, No. 1:17-cv-07007-CBA-RML (E.D.N.Y. Dec. 14, 2017), 2017 U.S. Dist. LEXIS 206145; Complaint, *REcoin Grp. Found.*, No. 17-cv-5725-RJD-RER (E.D.N.Y. Sept. 29, 2017). The SEC has continued its ad hoc enforcement strategy in 2019. *See generally, e.g.*, Complaint, SEC v. Kik Interactive Inc., No. 19-cv-5244 (S.D.N.Y. June 4, 2019).

20 *E.g.*, Letter from Ted Budd et al., Representative, U.S. House of Representatives, to Jay Clayton, Chairman, SEC (Sept. 28, 2018), https://budd.house.gov/uploadedfiles/budd_davidson_emmer_soto_sec_letter_final.pdf [https://perma.cc/Y55D-28N8]; *see* Kate Rooney, *Congress Members Ask SEC Chairman for Clarity on Cryptocurrency Regulation*, CNBC (Oct. 1, 2018, 10:26 AM), https://www.cnbc.com/2018/09/28/congress-ask-sec-chairman-for-clarity-on-cryptocurrency-regulation.html [https://perma.cc/4TC5-8QGR] (listing the signatories to the letter).

21 *E.g.*, Daniel Araya, *The Challenges of Cryptocurrency Regulation*, REG. REV. (Oct. 9, 2018), https://www.theregreview.org/2018/10/09/araya-challenges-cryptocurrency-regulation/ [https://perma.cc/FE9P-RRZT] ("[R]egulatory uncertainty limits the kinds of investors pursuing cryptocurrencies . . . . Going forward, we can be sure that ICOs and the cryptocurrency market as a whole will be increasingly subject to regulation. This is a very good thing.").

22 *See* TECH. ENGAGEMENT CTR., U.S. CHAMBER OF COMMERCE, FINTECH INNOVATION INITIATIVE 5 (2018), http://mfdf.org/images/US-Chamber-of-Commerce-fintech_agenda.pdf [https://perma.cc/7X2B-6BK4] ("[W]e urge the SEC to give more guidance on the treatments of tokens and [ICOs] to indicate whether a token is a security so companies can have more predictability and certainty in the marketplace.").

23 *See, e.g.*, Cease and Desist Order, Notice of Civil Penalty, Order for Rescission, and Notice of Right to Request a Hearing, In re BitConnect LTD (N.D. Sec. Dep't Sept. 19, 2018), http://www.nd.gov/securities/sites/default/files/enforcement/Cease%20%26%20Desist%20Order%20BitConnect.pdf [https://perma.cc/RQ74-GMPU]; Cease and Desist Order, In re Jinbi Ltd., No. CD-2018-0019 (Ala. Sec. Comm'n Sept. 18, 2018), http://www.asc.state.al.us/Orders/2018/CD-2018-0019.pdf [https://perma.cc/EA3G-HZ9V]; Emergency Cease and Desist Order, In re Symatri, LLC, No. ENF-18-CDO-1765 (Tex. State Sec. Bd. June 11, 2018), https://www.ssb.texas.gov/sites/default/files/ENF-18-CDO-1765.pdf [https://perma.cc/DD7W-87NP]; Consent Order, In re Sparkco, Inc., No. E-2018-0017 (Mass. Sec'y, Sec. Div. Mar. 27, 2018), http://www.sec.state.ma.us/sct/current/sctcryptocurrency/MSD-Sparkco-Consent-Order-E-2018-0017.pdf [https://perma.cc/G54H-YPBT]; Administrative Order to Cease and Desist, In re Swiss Gold Glob., Inc., No. 17021 (S.C. Sec. Comm'r Mar. 9, 2018), http://2hsvz0l74ah31vgcm16peuy12tz.wpengine.netdna-cdn.com/wp-content/uploads/2018/03/01621904.pdf [https://perma.cc/5NK2-RMGE]; Summary Cease and Desist Order, In re Bitcoin (N.J. Bureau of Sec. Mar. 7, 2018), https://nj.gov/oag/newsreleases18/ Bitcoiin-CD-03.07.18.pdf [https://perma.cc/S5YK-4K47].

24 TAPSCOTT & TAPSCOTT, *supra* note 16, at xxix.

25 *See* Vedder Price PC, *Highlights from SEC Speaks 2018: Litigation and Enforcement Trends*, LEXOLOGY (Mar. 5, 2018), https://www.lexology.com/library/detail.aspx?g=5f669278-

tokens distributed in exchange for private investment during fundraising are securities and that the SEC deserves deference from courts in token regulation.

Part I examines the ICO and its checkered history. Part II then explores the history of U.S. securities regulation in states and the federal government and the test that the SEC uses to determine whether an instrument is a security. It then analyzes tokens in the context of both state law and the SEC test and concludes that the very nature of prelaunch tokens brings them reasonably within the intentionally flexible definition of security. In Part III, the Essay turns to examining the SEC's suitability as a regulator and the deference it is owed when determining whether these novel instruments are securities.

I. Initial Coin Offerings

The ICO mirrors in many ways an IPO, but it occurs entirely using the recently developed technology known as blockchain.[26] Blockchain has most prominently been used as a hack-resistant publicly available ledger for Bitcoin[27] transactions, but it has been developed to support other cryptocurrencies and perform other functions requiring trust between parties, for example, transfers of assets that would usually occur through the public banking system.[28] This Part briefly examines Bitcoin, blockchain's first practical application, and other cryptocurrencies before discussing the workings of an ICO.

A. Cryptocurrency Development and the Beginnings of Blockchain

Before ICOs, there was Bitcoin. Bitcoin, the most valuable cryptocurrency in the world,[29] was founded on a simple concept: the shared public ledger.[30] By creating this public ledger and replicating it across a network of computers spanning the globe, Bitcoin created a protocol known as blockchain[31] that allows anyone receiving payment

1937-4e07-b3e0-64dfcae31802 [https://perma.cc/7YSJ-HAWC] (noting three prominent securities fraud cases prosecuted against ICO promoters).

26 *See Initial Coin Offering (ICO)*, *supra* note 10.

27 Bitcoin with a capital 'B' refers to the Bitcoin platform. In contrast, bitcoin with a lowercase 'b' refers to the currency.

28 *See* Arvind Narayanan et al., Bitcoin and Cryptocurrency Technologies 263–70 (2016). This is a prevailing authoritative volume on cryptocurrency technologies.

29 *See* Marco Iansiti & Karim R. Lakhani, *The Truth About Blockchain*, 95 Harv. Bus. Rev. 118, 120 (2017); *Top 100 Cryptocurrencies by Market Capitalization*, CoinMarketCap, https://coinmarketcap.com/ [https://perma.cc/4C2S-6ZBD].

30 Satoshi Nakamoto, Bitcoin 8 (2008), https://bitcoin.org/bitcoin.pdf [https://perma.cc/2HYZ-5PF2].

31 For the purposes of this Essay, unfamiliar readers should simply know that a blockchain

to verify automatically that a payer in fact owns the bitcoins she sends as payment, eliminating the need for an intermediary like a bank or broker.[32] It enables extremely fast and cheap domestic and international payments because it is accessible anywhere in the world with an open internet connection.[33]

Since Bitcoin's launch, developers and online communities have been conceptualizing ways to expand the use of blockchain technology.[34] One such use is the Ethereum network,[35] a more advanced blockchain that allows cryptocurrency trading but also enables "smart contracts," which are contracts recorded on the blockchain that automatically execute upon satisfaction of a coded condition.[36] This capacity created the conditions for the widespread ICOs happening today.

B. ICO Development

Since the first ICO occurred in 2013, raising just over $3 million dollars for a project that promised to add features to the Bitcoin blockchain, both the frequency and valuation of ICOs has skyrocketed. 2014 saw fewer than 10 ICOs;[37] 2018 saw over 600.[38] At least one ICO in every year since 2016 has raised over $150 million.[39] Although most ICOs would be lost in the rounding error when calculating global stock market capitalization,[40] the increase in global cryptocurrency

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is a uniquely secure record shared across many computers that stores regularly updated data. *See generally What is Blockchain Technology? A Step-by-Step Guide for Beginners*, BLOCKGEEKS (Mar. 1, 2019), https://blockgeeks.com/guides/what-is-blockchain-technology/ [https://perma.cc/BV4S-XLPY]; TAPSCOTT & TAPSCOTT, *supra* note 16.

32 *See How Do Bitcoin Transactions Work?*, COINDESK (Jan. 29, 2018), https://www.coindesk.com/information/how-do-bitcoin-transactions-work/ [https://perma.cc/N6LA-CCRJ].

33 *See, e.g.*, Martin Pochyla, *International Remittances and New Technologies*, *in* SELECTED PAPERS OF THE 19TH INTERNATIONAL CONFERENCE ON INFORMATION TECHNOLOGY FOR PRACTICE 251, 256 (Jan Ministr et al. eds., 2016).

34 These communities proliferate on the popular social network, Reddit. *See, e.g.*, *r/bitcoin*, REDDIT, https://www.reddit.com/r/bitcoin [https://perma.cc/V8VQ-APKX]; *r/CryptoTechnology*, REDDIT, https://www.reddit.com/r/CryptoTechnology [https://perma.cc/Q2G3-U478]; *r/ethereum*, REDDIT, https://www.reddit.com/r/ethereum/ [https://perma.cc/V3N9-AE6R].

35 *See* NARAYANAN ET AL., *supra* note 28, at 263–70.

36 *Id.* at 263. Just as bitcoin the currency is traded on Bitcoin the platform, ether, another currency, is traded on the Ethereum network. *See* Maxwell William, *ERC-20 Tokens, Explained*, COINTELEGRAPH (May 12, 2018), https://cointelegraph.com/explained/erc-20-tokens-explained [https://perma.cc/57XE-JDC9].

37 *See* Jay Preston, *Initial Coin Offerings: Innovation, Democratization and the SEC*, 16 DUKE L. & TECH. REV. 318, 318 & nn.1–2 (2018); *ICO Tracker*, COINDESK, https://www.coindesk.com/ico-tracker/ [https://perma.cc/L46U-9YK4] (select "Summary Stats").

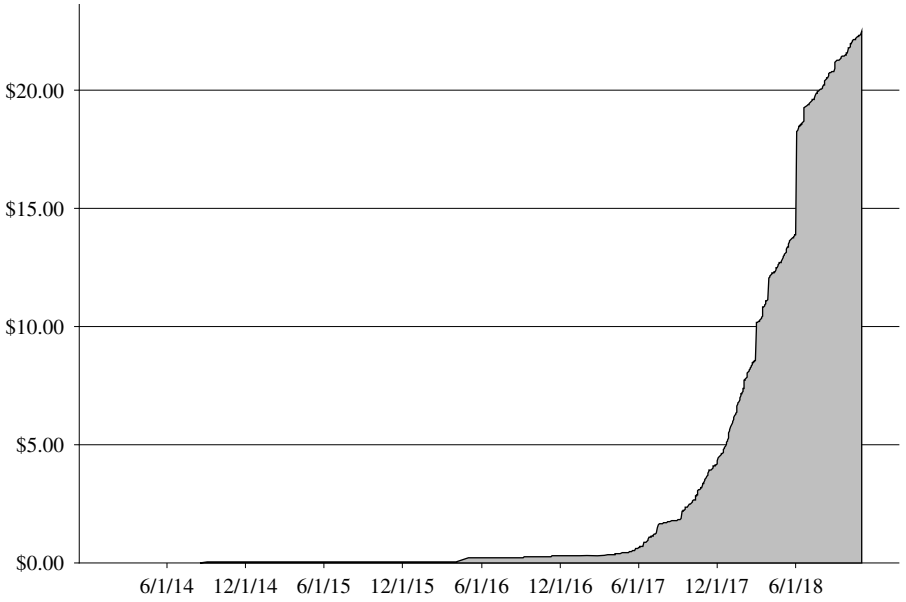
38 *See ICO Tracker*, *supra* note 37.

39 *Id.* The largest ICOs in 2016, 2017, and 2018 raised $152 million, $262 million, and $4.2 billion, respectively. *Id.*

40 The average ICO in 2018 raised $25.7 million. *Id.* (select "Average ICO Size by Year").

and token market capitalization has outpaced global stock-market capitalization tremendously.[41] If 2018 trends continue, companies will likely raise over $15 billion in over 500 ICOs.[42] Cumulative ICO fundraising over time is shown in Figure 1 below.

FIGURE 1. CUMULATIVE FUNDS RAISED IN ICOS (BILLIONS)[43]



Unsurprisingly, this meteoric rise caught the attention of governments, which regulate all large commercial markets. But before regulating anything, governments needed to answer what, exactly, is an ICO?

Procedurally, the ICO is simple. Typically, a company will publish a white paper detailing the company's business plan and the purpose

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Total global stock-market capitalization has been estimated in 2018 to be $68.7 *trillion*. *Market Capitalization of Listed Domestic Companies*, WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.LCAP.CD [https://perma.cc/3C4D-GZ7G].

41 The global stock-market capitalization increased by 5% in 2016 and 21.7% in 2017. *See Market Capitalization of Listed Domestic Companies*, *supra* note 40. The global cryptocurrency and token market capitalization—excluding bitcoin to avoid skewing the data—increased by 267% in 2016 and 16,382% in 2017. *See Global Charts: Total Market Capitalization (Excluding Bitcoin)*, COINMARKETCAP, https://coinmarketcap.com/charts/ [https://perma.cc/QX29-Q6U6] (calculating total market value minus bitcoin of $588 billion); *Total Market Cap*, NYSE, https://www.nyse.com/market-cap [https://perma.cc/WC9R-HWGK] (calculating 2017 year-end market capitalization of $27,846.175 trillion).

42 *See ICO Tracker*, *supra* note 37 (select "Summary Stats").

43 *Id.* (select "All-Time Cumulative ICO Funding").

and format of the ICO.[44] ICO participants then buy tokens[45] through online sales or on cryptocurrency exchanges with currency.[46] After reaching a specified fundraising threshold, the company delivers tokens to participants—logging transactions on a blockchain[47] by sending tokens to cryptocurrency wallets[48]—and uses the proceeds for business purposes.[49]

In many ways, an ICO is similar to an IPO of stock.[50] Functionally, an ICO works as a fundraiser for companies seeking either to (1) fund business development, generally with the understanding that the tokens purchased will be useable within the resulting business[51] or grant an ownership share in it,[52] or (2) create a new cryptocurrency to be traded broadly for goods and services.[53] Investors then trade these tokens on markets like they would trade shares of stock,[54] deliver

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44 *See Initial Coin Offering (ICO)*, *supra* note 10.

45 Not to be confused with "coins," a token is typically a unit of exchange traded on an existing blockchain network, such as Ethereum's. Coins are typically related only to their own blockchain, which is limited to transactions in the blockchain's currency. *See Crypto Token*, INVESTOPEDIA (Apr. 3, 2018), https://www.investopedia.com/terms/c/crypto-token.asp [https://perma.cc/6WKA-ZX9C]; *infra* note 50.

46 *Initial Coin Offering (ICO)*, *supra* note 10. Typically, an established cryptocurrency like bitcoin or ether is used. *Id.* Detailed accounts of specifics of cryptocurrency fall outside the scope of this Essay. For a detailed account of how cryptocurrencies like Bitcoin work and additional reading, see generally NARAYANAN ET AL., *supra* note 28, at 1–26, 51–75, 242–85.

47 This usually occurs on the Ethereum blockchain, although other networks supporting smart contracts and, therefore, ICOs exist. *See generally, e.g.*, ETHEREUM, https://www.ethereum.org/ [https://perma.cc/NAX2-XLWH].

48 These are secure online services or hardware that hold individuals' "cryptoassets," collections of cryptocurrencies and tokens. *See Cryptocurrency Wallet Guide: A Step-By-Step Tutorial*, BLOCKGEEKS, https://blockgeeks.com/guides/cryptocurrency-wallet-guide/ [https://perma.cc/4CXH-WA9W].

49 *Initial Coin Offering (ICO)*, *supra* note 10. If the ICO does not raise the company's minimum acceptable amount, the company returns the money to the participants. *Id.*

50 This analogy has its critics because a token often gives no ownership stake in the company, but Don and Alex Tapscott, cofounders of the Blockchain Research Institute, support this analogy, having initially coined what became ICOs as "blockchain IPOs." TAPSCOTT & TAPSCOTT, *supra* note 16, at xxxiv ("We dubbed it the 'blockchain IPO,' but the term never took off. Instead, people latched on to 'initial coin offering,' a misnomer if ever there was one.").

51 These rights are the hallmark of a "utility token," a token that can be used in the company's system in exchange for access rights, company services, or some other specified privileges. *Id.* at xxxiii–xxxv. These are sometimes called "[a]pp [c]oins." *Id.*

52 Ownership is the hallmark of a "security token," which operates like stock. Because the answer to the question of whether security tokens are securities is self-evident, it will not be analyzed here. *Id.* at xxxv–xxxvi; *see Initial Coin Offering (ICO)*, *supra* note 10.

53 *See Initial Coin Offering (ICO)*, *supra* note 10; *see also* Preston, *supra* note 37, at 320.

54 *See* KRAKEN, https://www.kraken.com/ [https://perma.cc/P9MU-724F]; *see also* ETHEREUM, *supra* note 47. The actual transfer process is quite simple. Buyers send bitcoins or ether to the cryptocurrency equivalent of an "account," a cryptocurrency wallet address designated by a string of letters and numbers (called a public key) designated by the company, and upon receipt

them to other people or organizations as payments or gifts[55] or use them to purchase goods or gain access to the company's services.[56]

This is where tokens diverge from stock. Once investors receive tokens, in many cases they can *use* the tokens.[57] Tokens usable on a network are known as utility tokens.[58] Apart from ownership in the company, an investor receiving stock typically receives only limited voting rights, rights to information, and the right to attend an annual meeting.[59] In contrast, a token purchaser often receives the right to receive services from the issuing company or participate in democratic company decisionmaking.[60]

But when an ICO participant purchases tokens, the participant cannot immediately use the tokens because the company will not have created the system on which they can be used yet. Think of this as purchasing one of a limited number of gift cards or transferrable memberships for a revolutionary gym that a company plans to build in your neighborhood. The gym only allows entry to members, who will also *own* the gym, and those who pay on a per-visit basis by gift card. Members will be able to vote on new classes and facilities—for example, a cycling room—to add to the gym once it is built and will receive a share of the revenue coming from these classes and facilities. Until the gym is built, the gift cards and memberships have no concrete value, and holders have no rights, but these gift cards and memberships can be sold and transferred freely to others who wanted to be

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of the funds, the company delivers a token to the buyer's account, the string of letters and numbers of the buyer's address. NAKAMOTO, *supra* note 30, at 6. Wallets can generate new addresses at the press of a button, and many, including Bitcoin's creator, recommend generating a new address for every transaction. *Id.* ("[A] new key pair should be used for each transaction to keep them from being linked to a common owner.").

55 The process to send a token is simple. All a user needs to deliver a token is the receiver's address (a string of letters and numbers that the receiver's wallet will create) and digital wallet software.

56 *See* Nathaniel Popper, *An Explanation of Initial Coin Offerings*, N.Y. TIMES (Oct. 27, 2017), https://www.nytimes.com/2017/10/27/technology/what-is-an-initial-coin-offering.html [https://perma.cc/PKA4-CZML].

57 *See supra* note 51 and accompanying text.

58 *See* TAPSCOTT & TAPSCOTT, *supra* note 16, at xxxiii–xxxv. Although other types of tokens and coins exist such as cryptocurrencies, protocol tokens, security tokens, natural asset tokens, cryptocollectibles, and crypto fiat currencies—each with hundreds of subcategories—this Essay will limit its analysis to utility tokens. *See id.* at xxix–xxx.

59 *See* 1 STEVEN M. HAAS, CORPORATE GOVERNANCE § 3.00 (Amy L. Goodman & Steven M. Haas eds., 2018).

60 *See* TAPSCOTT & TAPSCOTT, *supra* note 16, at xxxiii–xxxv; *see also, e.g.*, CHRISTOPH JENTZSCH, SLOCK.IT, DECENTRALIZED AUTONOMOUS ORGANIZATION TO AUTOMATE GOVERNANCE 2 (2016); STORJ LABS, INC., STORJ: A DECENTRALIZED CLOUD STORAGE NETWORK FRAMEWORK § 3.9 (2018), https://storj.io/storjv3.pdf [https://perma.cc/7LJY-PKU5].

members and missed out on the offering. Early adopters can profit by selling their memberships and gift cards. The gym might offer a discount of 5%, 25%, or even more to early adopters in the first days that the memberships and gift cards are on sale. This incentivizes early adopters who predict that the gym will be successful as they instantly realize gains when the price goes up. Eventually, hopefully, a gym opens, members and gift-card holders use the gym, and members vote, as expected, on new classes and additions and receive profit shares from them.

This hypothetical draws on current and past ICO practices, and organizations with each element have popped up across the ICO landscape.[61] But it is important to emphasize the delineation that occurs at the point that the gym opens, and the gift cards and memberships gain concrete value. Before the business opens, holders can never be certain that it will gain value. The tokens purchased during the ICO, the equivalent to the initial gift cards and memberships that have only theoretical future value, are the focus of this Essay.[62]

C. Token Examples

Before the end of 2018, over 1,000 ICOs took place, and each one promoted a unique business. Among the most notorious are The Decentralized Autonomous Organization ("The DAO") and Block.one, discussed in the Introduction. But before delving into their complex tokens, here is a simple example.

1. A Typical Utility Token—Primalbase

To demonstrate the typical case, this Essay looks to Primalbase, a blockchain-based shared workspace network.[63] Those who purchased Primalbase tokens ("PBT"),[64] which are valued in excess of $6,000,[65]

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61 *See infra* notes 63–83 and accompanying text.

62 The two hypothetical investments above raise particularly interesting questions once a business is operational about commodities and securities laws, but these questions fall outside this Essay's scope. *See generally* CFTC v. McDonnell, 287 F. Supp. 3d 213, 228 (E.D.N.Y. 2018) (holding that "[v]irtual currencies can be regulated by CFTC as a commodity"); Matthew De Silva, *SEC's Latest ICO Complaint Could Hint at Utility Token Debate*, ETHNEWS (May 29, 2018, 7:36 PM), https://www.ethnews.com/secs-latest-ico-complaint-could-hint-at-utility-token-debate [https://perma.cc/N7NH-KVF8].

63 *See* PRIMALBASE, https://primalbase.com/en/ [https://perma.cc/R6JM-J3TG]; Yoav Vilner, *Where Blockchain Meets the Trend of Co-Working Spaces*, FORBES (July 24, 2018, 4:05 PM), https://www.forbes.com/sites/yoavvilner/2018/07/24/where-blockchain-meets-the-trend-of-co-working-spaces/#414a8ac82494 [https://perma.cc/2VK6-58JC].

64 *Primalbase Token*, COINMARKETCAP, https://coinmarketcap.com/currencies/primalbase/ [https://perma.cc/8VE4-2TAV].

have the rights to use one desk in any of Primalbase's co-working spaces.[66] That is, tokenholders can walk into any Primalbase location, sit down at a desk, and work all day. Tokenholders can also *lease* their tokens to people who want to use the space in their stead.[67]

When purchased in an ICO, these tokens somewhat resemble memberships in the new neighborhood gym and the leases function similar to the gift cards purchased for the gym.[68] PBT tokens, which were used to finance the company and whose value will fluctuate with the business's success or failure,[69] confer on owners lifetime rights of access to the company's facilities.

2. *Notorious Utility Tokens—The DAO*

If the volume of published research is any guide, The DAO operated the most studied ICO to date.[70] It was created to operate as a pooled investment fund, "essentially a decentralized venture capital fund."[71] Tokenholders, who controlled The DAO, could submit investment proposals in the form of code-based smart contracts that the full body of tokenholders could then vote on.[72] If approved, the contract would be run, and any returns would flow back to The DAO.[73] For example, a tokenholder could propose a contract that would buy 10,000 shares of Apple and sell it in two years. The shares would be purchased, and, after two years, they would be sold, with gains (or losses) flowing back to The DAO.[74] Unfortunately, not long after The DAO launched, a hacker exploited The DAO's underlying code to siphon the cryptocurrency equivalent of about $50 million from The

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65 *Id.*

66 *See How It Works*, PRIMALBASE, https://primalbase.com/en/how-it-works/ [https://perma.cc/JMP8-ZA7U].

67 *Id.* As of the time of this writing, the rates to lease a token for a day are incredibly low, sometimes less than two Euros per day. *See Amsterdam*, PRIMALBASE, https://primalbase.com/en/workspaces/amsterdam/ [https://perma.cc/GU8X-XAT9] (listing current prices).

68 *See supra* Section I.B.

69 *See Primalbase Token*, *supra* note 64.

70 As of the time of printing, a search for "The DAO" and "Initial Coin Offering" turns up 452 results on Google Scholar, 200 on a Westlaw Secondary Source search, and 69 on a LexisNexis Secondary Materials search.

71 Randolph A. Robinson II, *The New Digital Wild West: Regulating the Explosion of Initial Coin Offerings*, 85 TENN. L. REV. 897, 930 (2018).

72 JENTZSCH, *supra* note 60, at 2.

73 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 [https://perma.cc/H7JE-73HG] (noting that The DAO would be the "only and direct recipient of . . . funds" received from its ICO and that tokenholders had "full control over the funds").

74 *See id.*

DAO funds.[75] Although The DAO creators rescued the stolen cryptocurrency, the project shut down.[76]

When purchased in an ICO, these tokens closely resemble the memberships purchased for the new neighborhood gym, with the coordinate ability to use gym facilities and vote on how the organization would do business in the future.[77]

3. Block.one

The ICO of Block.one's EOS token was the largest token fundraising to date.[78] Although its purchase agreement made no promises,[79] Block.one swapped one native EOS token useable on the EOSIO platform for each token purchased in the ICO, as expected.[80] The EOSIO platform can launch smart contracts, "dApps," or distributed applications, to operate any kind of business or organization imaginable, and among its possible uses is launching an ICO.[81] This requires a user to have EOS tokens. EOS holders also regularly trade tokens, with daily trading volume generally in the hundreds of millions of dollars.[82] Unfortunately, returns for tokenholders have not been good.[83]

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75 For a detailed contemporaneous account in plain English, see Brian Patrick Eha & Tanaya Macheel, *What the Attack on the DAO Means for Banks*, AM. BANKER (June 17, 2016, 6:22 PM), https://www.americanbanker.com/news/what-the-attack-on-the-dao-means-for-banks [https://perma.cc/EL7J-84AM].

76 *See* Jentzsch, *supra* note 73 (detailing the winding down of The DAO).

77 *See supra* Section I.B.

78 *See* Olga Kharif, *How's that ICO Working Out?*, BLOOMBERG BUSINESSWEEK (Dec. 14, 2018, 5:00 AM), https://www.bloomberg.com/news/articles/2018-12-14/crypto-s-15-biggest-icos-by-the-numbers [https://perma.cc/S8HT-WBWR].

79 *See supra* note 11 and accompanying text.

80 *See* Gareth Jenkinson, *Moment of Truth for EOS: What's Next for $4 Bln EOSIO Following Launch of v1.0*, COINTELEGRAPH (June 5, 2018), https://cointelegraph.com/news/moment-of-truth-for-eos-whats-next-for-4-bln-eosio-following-launch-of-v10 [https://perma.cc/64ZS-83RQ]; *supra* text accompanying note 13.

81 *See* Igor Yalovoy, *How to Create and Deploy Your Own EOS Token*, HACKER NOON (July 17, 2018), https://hackernoon.com/how-to-create-and-deploy-your-own-eos-token-1f4c9cc0eca1 [https://perma.cc/N6VE-6G4H].

82 *See Top 100 Cryptocurrencies by Market Capitalization*, *supra* note 29. Volume on the Bitcoin network alone is generally in the billions of dollars per day. *See Bitcoin*, COINMARKETCAP, https://coinmarketcap.com/currencies/bitcoin/ [https://perma.cc/E6FH-MYGV].

83 The EOS token has been steadily losing value, down from its April 2018 high of $22.89 to just $7.17 at the time of publishing. *EOS*, COINMARKETCAP, https://coinmarketcap.com/currencies/eos/ [https://perma.cc/ZWY7-4EMN]. It is now worth less than half of the value that EOS ICO participants invested, perhaps in part due to a failure to meet stated network performance goals. *See* Zak Cole et al., *EOS: An Architectural, Performance, and Economic Analysis*, HACKER NOON (Nov. 19, 2018), https://hackernoon.com/eos-an-architectural-performance-and-economic-analysis-43a466064712 [https://perma.cc/EEA6-JWHD] (noting EOSIO's complete

These tokens have elements of both the gift cards and the memberships of the neighborhood gym: users can use their tokens to run code, which they would do in order to run a dApp or smart contract, on the EOSIO blockchain, thereby spending it. But users can also use them to vote for block producers,[84] which are the individual computer groups that record code onto the blockchain and keep it secure and up to date.[85]

4. Characteristics Inherent in Prelaunch Tokens

Key to this discussion is the status of the tokens when they are sold by a company for the purpose of fundraising. Most literature promoting tokens or arguing for only relatively light regulation focuses on tokens as a system of governance (as in The DAO) or payment for services (as in Primalbase) arguing that regulation will stifle innovation in these new domains.[86] But these domains are only a part of the whole picture; this Essay is much more concerned with employing tokens as a means of *fundraising*. Handing money to a startup that promises a product in the future, as was the case with the neighborhood gym,[87] is much riskier than purchasing a gift card for Amazon.com. Most startups fail,[88] and, largely because of that risk, the SEC generally limits investment in them to a small set of investors who usually (1) have qualifications that suggest that they have stable

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failure to achieve performance goals and concluding that "it has become apparent that in order for EOS to be able to successfully act as a foundational base layer protocol, it needs to re-architect a signi?cant portion of its infrastructure").

84 For background on the role of block producers, see generally Kyle Samani, *The Definitive Voting Guide for EOS Block Producers*, FORBES (Sept. 18, 2018, 10:00 AM), https://www.forbes.com/sites/ksamani/2018/09/18/the-definitive-voting-guide-for-eos-block-producers/#56207394d4f0 [https://perma.cc/X4J3-T7TQ].

85 *See* BLOCK.ONE, *EOS.IO Technical White Paper v2*, GITHUB (Mar. 16, 2018), https://github.com/EOSIO/Documentation/blob/master/TechnicalWhitePaper.md [https://perma.cc/9QJM-GTTH].

86 *E.g.*, Robinson, *supra* note 71, at 904 (asserting that "a heavy-handed regulatory crackdown will lead to the loss of . . . innovation").

87 *See supra* Section I.B.

88 This includes token and coin creators. *See, e.g.*, John Biggs, *Thousands of Cryptocurrency Projects Are Already Dead*, TECHCRUNCH (June 29, 2018), https://techcrunch.com/2018/06/29/thousands-of-cryptocurrency-projects-are-already-dead/ [https://perma.cc/4M3R-9WBX]; Bertie Conibear, *The Simple Truth that ICO's Forgot: Offer Value to Your Customer*, HACKER NOON (Dec. 10, 2018), https://hackernoon.com/the-simple-truth-that-icos-forgot-1d7b9ab9f77f [https://perma.cc/N9TD-XJZY] (discussing reports of billions of dollars lost in failed and scam ICOs and high rate of fraud).

finances—as is the case with accredited investors—and (2) know the ins and outs of investing in private businesses.[89]

By focusing only on the operation of token-based organizations once operational, commentators often ignore the extreme risks of speculative early-stage investing inherent in ICOs.[90] These are the risks that the SEC attempts to eliminate with its registration and disclosure regimes.[91] Although several arguments exist that these regimes overregulate, thus stifling innovation, the arguments are not unique to ICOs.[92]

D. Risks

Any investment carries some risk.[93] Even a gym membership can prove a bad investment if the gym declares bankruptcy in the middle of a year-long membership contract. But unregulated tokens carry significantly more risk than your local gym's bankruptcy, during which aggrieved members could always be represented in the bankruptcy proceeding.[94]

1. Hacking Security Risks

One of the chief risks posed by tokens and all cryptocurrencies discussed by the SEC Chairman, citing it as one of two primary reasons for denying registration to several bitcoin and cryptocurrency exchange-traded funds ("ETFs"),[95] is their inherent susceptibility to hacking.[96] In likely the most famous instance of cryptocurrency theft, hackers took 850,000 bitcoins, then worth about $475 million, from a

89 *See* Susanna Kim Ripken, *Paternalism and Securities Regulation*, 21 STAN. J.L. BUS. & FIN. 1, 12–13 (2015).

90 *See, e.g.*, Jean Bacon et al., *Blockchain Demystified: A Technical and Legal Introduction to Distributed and Centralised Ledgers*, 25 RICH. J.L. & TECH. 1, ¶ 167, at 79 (2018).

91 *See* Ripken, *supra* note 89, at 2.

92 *See infra* notes 296–97 and accompanying text.

93 *"High Yields" and Hot Air*, U.S. SEC. & EXCHANGE COMMISSION (Apr. 11, 2005), https://www.sec.gov/reportspubs/investor-publications/investorpubsinvestorfraudhtm.html [https://perma.cc/9RT7-S8YD].

94 Bacon et al., *supra* note 90, ¶¶ 171–75, at 81–83.

95 ETFs are investments sold like shares of stock on public stock exchanges; an ETF generally invests in a category-specific or index-matching portfolio of companies or other assets, and its value is determined by the value of the underlying assets. *E.g.*, *What's an ETF?*, VANGUARD, https://investor.vanguard.com/etf/ [https://perma.cc/8XQP-V4QZ].

96 Zack Seward, *SEC Chairman Jay Clayton's Full Consensus: Invest Interview*, COINDESK (Nov. 28, 2018, 10:13 PM), https://www.coindesk.com/sec-jay-clayton-consensus-invest-video [https://perma.cc/RG5B-REGN] (interview at 26:20) (noting that the SEC is concerned about cryptoassets' "risk of theft or disappearance" due to cybersecurity challenges).

bitcoin exchange.[97] Because discovering relatively short private alphanumeric keys is the only thing that hackers need to do to steal many cryptocurrencies, significant security measures and redundancies are necessary to properly safeguard accounts.[98] And as noted above, a rogue actor exploited a flaw in The DAO's code shortly after its ICO, siphoning off the equivalent of about $50 million in cryptocurrency.[99] Hackers transfer cryptoassets to their own wallets and then disappear, becoming very difficult to find thanks to the inherent pseudonymity of most blockchains, including Bitcoin.[100]

2. Illegal Trading Tactics

Pseudonymity inherent in cryptocurrency wallets also permits freedom to manipulate cryptocurrency markets, which is banned on securities exchanges by the Securities Exchange Act of 1934 ("Exchange Act").[101] For example, suppose a company launches an ICO and raises $10 million but sells only 25% of the tokens that it has created. It had previously raised $2 million from a private investor, and, unbeknownst to ICO participants, it invested its $2 million in the offering as well. Here is where the manipulation comes in. The company then creates a few cryptocurrency wallets and begins trading its $2 million in circles, each time generating a new address, meaning that observers cannot tell that the trades are occurring in a small group of wallets held by the company. This heavy trading volume spurs interest and causes the token price to rise. Now the company can sell parts of the 75% of tokens that it retained at an elevated price based purely on market manipulation.

This presents one of the largest challenges to measuring the growth and use of cryptocurrencies.[102] Market manipulation has been

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97 *See* Jen Wieczner, *$1 Billion Bitcoins Lost in Mt. Gox Hack to Be Returned to Victims*, FORTUNE (June 22, 2018), http://fortune.com/2018/06/22/bitcoin-price-mt-gox-trustee/ [https://perma.cc/VYE8-PJUQ]. 200,000 of the coins were later rediscovered. *See id.*

98 *See* Brian O'Connell, *Bitcoin and Cryptocurrencies: Are They Safe?*, EXPERIAN (Nov. 30, 2017), https://www.experian.com/blogs/ask-experian/bitcoin-and-cryptocurrencies-are-they-safe/ [https://perma.cc/5N64-ZMK6] ("Bitcoin hacking is a popular criminal enterprise because if that key is compromised, the attackers can send all of the victim's Bitcoin to themselves or an intermediary or simply delete the key and digitally eliminate the Bitcoin." (quoting Andrew McDonnell, President, AsTech)).

99 *See supra* text accompanying notes 75–76.

100 *See supra* text accompanying notes 75–76.

101 15 U.S.C. §§ 78i–78j (2012).

102 *See* Paul Vigna & Alexander Osipovich, *Bots Are Manipulating Price of Bitcoin in 'Wild West of Crypto*,' WALL STREET J. (Oct. 2, 2018, 8:00 AM), https://www.wsj.com/articles/the-bots-manipulating-bitcoins-price-1538481600 [https://perma.cc/V79D-JZ6X].

blamed for Bitcoin bubbles in years past,[103] and companies face regular accusations of manipulation using tactics like wash trading,[104] pumping and dumping,[105] and Ponzi schemes.[106] Commentators continue to regularly call out probable market manipulation. But the lack of transparency, owing in part to the lack of SEC regulation, means that companies do not release independent audit reports, and cryptocurrency exchanges have not implemented methods to curb manipulative practices.[107] The SEC Chairman himself cites this risk of market manipulation as the other primary reason for denying approval for cryptocurrency-backed ETFs.[108]

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103 *E.g.*, Kate Rooney, *Much of Bitcoin's 2017 Boom Was Market Manipulation, Research Says*, CNBC (June 13, 2018, 1:22 PM), https://www.cnbc.com/2018/06/13/much-of-bitcoins-2017-boom-was-market-manipulation-researcher-says.html [https://perma.cc/AB8D-P8CQ] (discussing study finding that "at least half of the jump in bitcoin [prices during a recent bubble] was due to coordinated price manipulation").

104 *See, e.g.*, Melanie Kramer, *Bithumb Accused of Wash Trading*, ETHNews (Dec. 20, 2018, 7:52 PM), https://www.ethnews.com/bithumb-accused-of-wash-trading [https://perma.cc/P8BY-PCJC]. Wash trading happens when an investor sells shares of an investment and then, within a short period of time, buys the shares back, resulting in no change of ownership. *Wash Sale*, Black's Law Dictionary (10th ed. 2014).

105 *See, e.g.*, Lauren K. Ohnesorge, *Bitcoin CEO Accused in 'Pump-and-Dump' Scheme Takes Leave of Absence from Durham Firm*, Triangle Bus. J. (Sept. 13, 2018, 7:27 AM), https://www.bizjournals.com/triangle/news/2018/09/13/bitcoin-ceo-accused-in-pump-and-dump-scheme-takes.html?s=print [https://perma.cc/4AQH-HE5Q]. Pump-and-dump schemes involve attempting to manipulate investment prices by spreading false, exaggerated statements and high sales figures about the investment; the investor spreading the information then sells all her shares at the peak and walks away with the misled investors holding the bag. *See Pump and Dump*, Investopedia (Apr. 26, 2019), https://www.investopedia.com/terms/p/pumpanddump.asp [https://perma.cc/N72Y-X67W]. The Commodity Futures Trading Commission has gone so far as to formally warn consumers about virtual currency pump and dump schemes. *Customer Advisory: Beware Virtual Currency Pump-and-Dump Schemes*, U.S. Commodity Futures Trading Commission, https://www.cftc.gov/sites/default/files/idc/groups/public/@customerprotection/documents/file/customeradvisory_pumpdump0218.pdf [https://perma.cc/TL28-K2X7].

106 BitConnect, long suspected of operating a Ponzi scheme with its token, BCC, closed down in January 2018. *See* Simon Chandler, *This Week's Bitcoin Crash Was All About Fraud and Regulation*, Verge (Jan. 18, 2018, 9:35 AM), https://www.theverge.com/2018/1/18/16905040/bitcoin-crash-cryptocurrency-value-ethereum-regulation [https://perma.cc/PS8F-M7BP]; Dimitar Mihov, *Ethereum's Vitalik Buterin: Biggest Bitcoin Investment Platform Likely Is a Ponzi Scheme*, Next Web (Nov. 3, 2017), https://thenextweb.com/insider/2017/11/03/ethereum-buterin-bitcoin-bitconnect/ [https://perma.cc/YD9M-5WE5].

107 *See* Aaron Stanley, *Time for a Clean up? Market Manipulation Concerns Loom Large over Bitcoin ETF Rejections*, Forbes (Aug. 23, 2018, 8:39 PM), https://www.forbes.com/sites/astanley/2018/08/23/time-for-a-clean-up-market-manipulation-concerns-loom-large-over-bitcoin-etf-rejections/#72ea5ffd1ecd [https://perma.cc/9CXY-48B5] (noting that the SEC declined to approve proposals for a bitcoin ETF because the underlying market was underpoliced and prone to market manipulation and fraud).

108 Seward, *supra* note 96 (interview at 27:45) (noting that on public stock exchanges "there [are] rules and surveillance designed to prevent manipulative techniques, such as the two of us agreeing to sales at high prices in order to drive the price up so that we could then sell our

There is a remedy to these risks, and it is SEC regulation. The SEC is aware of the risks inherent in investing, and, for nearly a century, it has regulated securities in order to protect investors through a broad scheme of disclosure.[109]

II. Defining a Security

When Congress enacted the Securities Act of 1933 ("Securities Act")[110] and the Exchange Act (collectively, "Securities Acts"), which established and gave power to the SEC, it was acting in response to the Great Depression.[111] Eyes were focused on exchanges and financial markets, and states previously had some success regulating these markets using "blue sky laws,"[112] so it was no surprise when the federal government began regulating them too.

More recently, with $20 billion invested in ICOs over the last three years and a long trail of fraud and abuse littered along the way,[113] the SEC surprised no one by stepping into the ring to protect investors in 2017.[114] In its report examining The DAO before beginning enforcement, the SEC did not send mixed signals to ICO promoters:

> [Securities Act registration] 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.[115]

Simply put, your tokens are securities.

This conclusion was unsurprising to many;[116] regulating tokens that look like investments promotes the goals of blue sky regulation

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securities when others jumped in," and that "those kinds of safeguards do not exist currently in all of the exchange venues where digital currencies trade").

109 *See* Ripken, *supra* note 89, at 45–49.

110 15 U.S.C. §§ 77a et seq. (2012).

111 *See, e.g.*, Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Stan. L. Rev. 385, 409 (1990) (noting that "the Exchange Act was the product of the unique circumstances of the Depression").

112 *See infra* Section II.A.

113 *See supra* Part I.

114 *See supra* notes 17–19 and accompanying text.

115 The DAO Report, *supra* note 17, at 18.

116 *See, e.g.*, Jeff John Roberts, *The SEC's Big Digital Coin Ruling: What It Means*, Fortune (July 26, 2017), http://fortune.com/2017/07/26/sec-icos/ [https://perma.cc/G7RE-MW3X] ("ICO skeptics have long warned that, in many cases, the tokens for sale are simply a new form

and the Securities Acts.[117] Yet many others have argued that some tokens are different, that their very nature separates them from existing organizational structures,[118] and that overregulation could hamstring the innovative future to which ICOs are transporting us.[119] But comparing the substance of ICOs to the substance of investments initially regulated by blue sky laws and the Securities Acts demonstrates that early state regulators and the Congress enacting the Acts would have viewed tokens as securities and either enumerated them within the Acts' definitions or the "flexible" concept of the investment contract. The relevant history of securities regulation below will guide this Essay's analysis.

A. State Blue Sky Regulation

Modern federal securities regulation grew out of states' regulation, as far back as 1911, of promoters selling speculative investments.[120] State statutes, called blue sky laws, mandated registration and disclosure by people promoting speculative investments.[121] Like modern securities regulations, states enacted these laws to protect unknowing investors from swindlers, liars, and, likely, incompetent businesspeople.[122] Originating in Kansas, other states quickly adopted similar provisions,[123] and by the early 1920s, nearly every state had

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of shares—and that selling them without a license violates federal securities laws."); Gary J. Ross, *The SEC States the Obvious: DAO Tokens Are Securities*, ABOVE L. (July 27, 2017, 5:03 PM), https://abovethelaw.com/2017/07/the-sec-states-the-obvious-dao-tokens-are-securities/ [https://perma.cc/2EKA-CMW2].

117 *See infra* notes 120–29, 146–50 and accompanying text.

118 *See, e.g.*, Ori Oren, Note, *ICO's, DAO's, and the SEC: A Partnership Solution*, 2018 COLUM. BUS. L. REV. 617, 651–58 (arguing for a new "[d]ecentralized [p]artnership" business structure).

119 Robinson, *supra* note 71, at 904 ("[A] heavy-handed regulatory crackdown will lead to the loss of both innovation and capital investment opportunities, and . . . while it is actively asserting itself in the ICO space, the SEC will face considerable challenges to enforcing U.S. securities laws in the global blockchain ecosystem.").

120 *See* THOMAS LEE HAZEN, PRINCIPLES OF SECURITIES REGULATION § 58, at 178 (3d ed. 2009) ("[T]he Kansas legislature was spurred [to enact securities laws] by the fear of fast-talking eastern industrialists selling everything including the blue sky.").

121 *See id.* § 58, at 178–79.

122 *E.g.*, State v. Heath, 153 S.E. 855, 857 (N.C. 1930) ("The purpose of the[se] law[s] . . . [was] to protect the public against the imposition of unsubstantial schemes and the securities based upon them." (quoting Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917))); Joseph W. Kiernan, *Judicial and Administrative Control over Promoters' Profits*, 28 GEO. L.J. 535, 543 (1940) ("[States' regulatory] aim is to put a stop to the sale of shares in visionary oil wells, nonexisting gold mines, and other 'get-rich-quick' schemes calculated to despoil credulous individuals of their savings." (quoting State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920))).

123 *See* Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L.

blue sky laws.[124] Because the investment schemes were allegedly carried out by shady characters in myriad ways against unsuspecting victims,[125] states attempted to regulate them by defining "security" broadly.[126] Laws regulated stocks, bonds, and "investment contracts," among other things.[127] Investment contracts were understood to be any schemes in which investors "la[id] out . . . money in a way intended to secure income or profit from its employment."[128] This broad definition permitted broad application of securities laws against anyone seeking money on the promise of paying it back with added returns.[129] The test asked only one question: Are you investing money and expecting income from the investment?

Even after these laws were implemented, reports of securities fraud ran rampant, and fraud through the mail, over which the states had little to no control, was purportedly sucking hundreds of millions of dollars from the economy each year.[130] After years of debate about

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REV. 347, 377–80 (1991). Every state now employs blue sky laws to regulate securities. HAZEN, *supra* note 120, § 58, at 178.

124 1 ROBERT N. RAPP, BLUE SKY REGULATION § 1.02[1] (2018).

125 *See* Macey & Miller, *supra* note 123, at 389 ("[B]lue sky laws were typically justified . . . as a means to thwart the schemes of . . . people who were denigrated repeatedly as fly-by-night operators, fraudulent promoters, robbers, cancers, vultures, swindlers, grafters, crooks, goldbrick men, fakirs, parasites, confidence men, bunco artists, [and] get-rich-quick Wallingfords . . . [a]gainst . . . victims[] usually portrayed as innocent, weak minded, vacillating, foolish, or guileless . . . widows, orphans, farmers, little idiots[,] or working people."). Macey and Miller posit that states' justifications were quite simple: "[T]he fraudulent salesmen were palming bad merchandise off on the innocent and unsophisticated public, and the blue sky laws were the way to stop the practice." *Id.* at 390.

126 *E.g.*, 1919 Minn. Laws 99, 101–02 (regulating any "person, firm, []partnership, corporation, company[,] or association . . . selling, *offering*[,] or negotiating for the sale of any stocks, bonds, investment contracts[,] or *other securities*") (second emphasis added); *cf.* SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946) ("[Investment contract] had been broadly construed by state courts so as to afford the investing public a full measure of protection.").

127 *E.g.*, *id.*

128 *E.g.*, State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920); *see also* Trivectra v. Ushijima, 144 P.3d 1, 11 (Haw. 2006); Scholarship Counselors, Inc. v. Waddle, 507 S.W.2d 138, 141 (Ky. Ct. App. 1974); State v. Heath, 153 S.E. 855, 857 (N.C. 1930); King v. Pope, 91 S.W.3d 314, 320 n.4 (Tenn. 2002).

129 *See King*, 91 S.W.3d at 320 n.4.

130 *See* Forrest Bee Ashby, *Federal Regulation of Securities Sales*, 22 ILL. L. REV. 635, 635 (1928) (noting that the post office, which the author accused of exaggeration, estimated annual securities fraud costs at $1,000,000,000, twenty percent of which it attributed to state regulatory failures); *see also* Macey & Miller, *supra* note 123, at 355–56 (noting the postal service's likely exaggeration). In 1915, the Counsel for the Investment Bankers Association wrote that securities "dealers may, as a matter of law, safely ignore . . . [blue sky] laws in strictly interstate transactions"—transactions often facilitated by mail. *Id.* at 388–89 (quoting *The Blue Sky Laws*, 91 BANKERS MAG. 588, 590 (1915)).

the suitability of federal regulation,[131] the Great Depression gave the federal government the final push it needed to start regulating securities itself.[132]

Because federal securities definitions were drawn from state blue sky laws, it follows that application of early blue sky cases would inform their application.[133] The prevailing test, later adopted and adapted by the Supreme Court, asked whether an investor laid out money in a way intended to secure income or profit from its employment.[134] Its creators employed the test broadly, for example, by holding that blue sky laws "should not be given a narrow construction[,] for it was the evident purpose of the Legislature to bring within the statute the sale of all securities not *specifically exempted*."[135]

First, Primalbase and DAO tokens plainly fall within this definition.[136] In the case of Primalbase, investors laid out money to gain access to Primalbase facilities, surely, but they also laid out money with the hope of earning returns.[137] The company confirmed as much, stating that it would launch projects "to help increase the value of" the Primalbase token, PBT.[138] In the case of The DAO, investors laid out money to vote on ventures in order to invest money to hopefully earn a profit from.[139]

Second, a feature of the Primalbase ICO should presumptively bring tokens within the definition of a security under this test. Primalbase employed a discount to those who bought PBT on the first day that it was available, selling most tokens this way.[140] After that sale, the cost of a token *increased* for those purchasing from the company.[141] Because more tokens were sold at this higher price, the market value immediately increased for the tokens sold at the discounted

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131 *See generally* Ashby, *supra* note 130, at 638–45 (discussing debate about specific federal blue sky regulations).

132 *See* Billy Ray Hall, Jr., A Legal Solution to Government Gridlock 83 (1998).

133 *See supra* note 128 and accompanying text.

134 *See supra* text accompanying note 128.

135 State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920) (emphasis added).

136 In the case of Primalbase, this is only true with token owners—not lessees, who simply expect to be able to use facilities at the agreed-upon leasing price. *See supra* Section I.C.

137 The investors received their tokens in exchange for bitcoins, an established type of money. *See infra* notes 160–61 and accompanying text.

138 Guy Brandon, *Primalbase Crowdsale Ends After One Day and Over 3,000 BTC Raised!*, Waves Platform (June 28, 2017), https://blog.wavesplatform.com/primalbase-crowdsale-ends-after-one-day-and-over-3-000-btc-raised-7e8a9151e99c [https://perma.cc/Q34A-WB37].

139 The DAO Report, *supra* note 17, at 11.

140 Brandon, *supra* note 138.

141 *See Primalbase Token*, *supra* note 64.

price.[142] This feature, called a tiered-price offering, is "ubiquitous in the ICO environment."[143] This tiered-price offering tactic innately demonstrates an expectation of profits in early investors—the tiered-price scheme exists to persuade investors to invest early to secure instant returns.[144] Because of the profit motive inherent in these schemes, ICOs employing them in sales would have presumptively been securities under the early blue sky laws.

B. The Modern Era: SEC v. W.J. Howey Co.

> Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.
>
> —*Reves v. Ernst & Young*[145]

Against the backdrop of state blue sky laws and the Great Depression, Congress began regulating securities with the Securities Acts, which still govern securities regulation today. Following the model of blue sky laws, Congress defined securities broadly.[146]

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142 *See id.*

143 Tim Enneking et al., *The Seven Pillars of ICO Investing*, COINDESK (Apr. 17, 2018, 7:39 PM), https://www.coindesk.com/seven-pillars-ico-investing [https://perma.cc/GW75-QZHC]. In these offerings, a company sells an initial batch of tokens, sometimes called a "presale," at a discounted price—this is commonly referred to as an ICO discount or bonus. *See* Madi Omar, *Most Popular Bonus & Discount Types in ICOs*, MEDIUM (Feb. 13, 2018), https://medium.com/etherflair/most-popular-bonus-discount-types-in-icos-1250ad7ef2f1 [https://perma.cc/Z9ED-H7NS]; *What Is an ICO Pre Sale?*, ICO WATCH LIST, https://icowatchlist.com/presale [https://perma.cc/L57B-XD42]. When the company then raises the price for subsequent sales, sometimes occurring just days later, tokens will be added to the market at a higher price, and in doing so, they instantly raise the value of the tokens purchased earlier at a lower price. *See Initial Coin Offering – ICO*, ETHEREUM PRICE, http://www.ethprice.com/ico/ [https://perma.cc/Y83Y-DCGY].

144 *See* Tom Alford, *ICO Investing Beginner's Guide – How to Get Involved*, TOTALCRYPTO.IO (Feb. 27, 2018), https://totalcrypto.io/ico-investing-guide/ [https://perma.cc/5BVS-E6BY].

145 494 U.S. 56, 61 (1990).

146 The definitions of security in the Securities Acts are not identical, but the Court generally treats them as such for the purposes of defining a security. SEC v. Edwards, 540 U.S. 389, 393 (2004) ("[W]e have treated [the definitions of a security under the Securities Acts] as essentially identical in meaning . . . ."). The Acts initially included the following definition of a security:

> The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, re-

Enumerating a list of at least 17 vehicles[147] to be included within the definition of a security, the Securities Acts also include "[any] instrument commonly known as a 'security,'"[148] demonstrating a desire to sweep within their scope any future instrument that serves an investment purpose.[149] And the Supreme Court has said as much: "[Congress] enacted a broad definition of 'security,' sufficient 'to encompass virtually any instrument that *might* be sold as an investment.'"[150]

When assessing a potential security, courts primarily focus on one vehicle: the investment contract.[151] Since the landmark decision in *SEC v. W.J. Howey Co.* ("*Howey*"),[152] courts have determined whether an instrument or investment is a security by asking whether the buyer (1) "invests his money" (2) "in a common enterprise" (3) "and is led to expect profits" (4) "solely from the efforts of" other people.[153] This test is intended to be a flexible one, able to adapt to

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> ceipt for, guaranty of, or warrant or right to subscribe to or purchase, any of the foregoing.

SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350 n.6 (1943) (quoting 15 U.S.C. § 77b(1) (1940)). The Securities Acts now include additional instruments, including any "put, call, straddle, option, or privilege" on securities and foreign currencies. 15 U.S.C. § 77b(a)(1) (2012).

147 A definitive count is elusive because the precise number of enumerated vehicles depends on the interpretation of numerous conjunctions and oddly placed commas. *See* 15 U.S.C. § 77b(a)(1).

148 *Id.*

149 *See* James S. Mofsky, *Some Comments on the Expanding Definition of "Security,"* 27 U. MIAMI L. REV. 395, 397 (1973) ("[T]he framers of state and federal securities statutes opted for extremely broad catchall terms . . . .").

150 *Edwards*, 540 U.S. at 393 (emphasis added) (quoting *Reves*, 494 U.S. at 61).

151 *See* HAZEN, *supra* note 120, § 5, at 28 ("The judicial definition of security has developed primarily from interpretation of the statutory phrase 'investment contract.'"). The Supreme Court has noted in at least one instance that "an instrument commonly known as a 'security'" and an "investment contract" are effectively the same. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975) ("We perceive no distinction, for present purposes, between an 'investment contract' and an 'instrument commonly known as a "security."' In either case, the basic test for distinguishing the transaction from other commercial dealings is [the *SEC v. W.J. Howey Co.* test]." (quoting 15 U.S.C. § 77b(1))).

152 328 U.S. 293 (1946). To sum up *Howey* briefly, W.J. Howey Company sold interests in a 500-acre orange grove to investors, mostly visitors to its nearby resort, and the company required the investors to hire by multiyear service contract a company to cultivate, harvest, and market the citrus crop. *Id.* at 294–97. Investors could not access the market for their crop without W.J. Howey's consent, and one service company that serviced 85% of the investors' plot acreage pooled together the crop of all the owners who hired it, sold the crop, and distributed profits based on checks that it made at the time of picking. *Id.* at 295–96. The Supreme Court, evaluating whether the land sales in combination with the service contracts were securities, held that this scheme satisfied the test. *Id.* at 298–99.

153 *Id.*

"the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[154]

The *Howey* test remains the standard definition for an investment contract.[155] The contours of each prong, as adapted by the Supreme Court since *Howey*, and the way that they apply to ICOs today follows.

1. *An Investment of Money—"Some Tangible and Definable Consideration"*

This prong is the simplest. Although *Howey* does not define "investment of money" within its four corners, the Supreme Court has held things to be securities when "the person found to have been an investor chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security."[156] This definition is somewhat obvious; it defines an investment in a security as relinquishing specific consideration in return for an interest resembling a security.

The Court expounded this definition in *International Brotherhood of Teamsters v. Daniel*,[157] where it held that receiving a pension as part of an indivisible compensation package did not render the pension a security because there was no "specific consideration" in exchange for the pension, a small part of an overall compensation package not resembling a security.[158] Summarizing its practical test, the Court said that the investor must give up "some tangible and definable consideration in return for an interest that ha[s] substantially the characteristics of a security."[159]

This prong is easily met with ICOs. Investors purchase tokens with cryptocurrencies, and courts have construed cryptocurrency pay-

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154 *Id.* at 299. Courts have applied the *Howey* test to encompass partnerships, interests in real estate including fractional ownership, and franchise arrangements. *See, e.g.*, Holden v. Hagopian, 978 F.2d 1115, 1119 (9th Cir. 1992) (holding that a general partner who theoretically retains power to control over an investment but is in fact so dependent on a third party or promoter that he cannot exercise his control holds a security in the business); LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 253–56 (5th ed. 2004).

155 *E.g.*, *Edwards*, 540 U.S. at 393.

156 Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 559 (1979).

157 439 U.S. 551 (1979).

158 *Id.* at 559–60 ("Only in the most abstract sense may it be said that an employee 'exchanges' some portion of his labor in return for these possible [pension] benefits. He surrenders his labor as a whole, and in return receives a compensation package that is substantially devoid of aspects resembling a security.").

159 *Id.* at 560.

ments as transactions of money.[160] The unanimity of scholarship on this issue adds to this near certainty.[161]

2. *In a Common Enterprise*

"Common enterprise" is not well defined in the law. Its entry in *Black's Law Dictionary* refers readers to "joint enterprise," which it unhelpfully defines under criminal, tort, and business association law.[162] The *Howey* Court appears to have used the phrase without reference to any existing definition; although the words "common enterprise" had appeared in prior Supreme Court opinions, they had conflicting interpretations in federal courts.[163] The common enterprise finding at least requires that investor returns be tied to success and failure of other investors or actors in the enterprise.[164]

Where the Supreme Court has not provided guidance, lower courts and scholars have rushed to fill the void.[165] Three definitions predominate: horizontal commonality, broad vertical commonality, and strict vertical commonality.[166] At least one scholar argues that the true definition of a common enterprise is a relatively simple, pragmatic test that asks whether a promoter has engaged in an enterprise with multiple investors and offered them "essentially the same instru-

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160 *E.g.*, United States v. Faiella, 39 F. Supp. 3d 544, 545 (S.D.N.Y. 2014) ("Bitcoin clearly qualifies as 'money' or 'funds' . . . . Bitcoin can be easily purchased in exchange for ordinary currency, acts as a denominator of value, and is used to conduct financial transactions."); SEC v. Shavers, No. 4:13-CV-416, 2013 U.S. Dist. LEXIS 110018, at *4–5 (E.D. Tex. Aug. 6, 2013) ("It is clear that Bitcoin can be used as money. It can be used to purchase goods or services, and as Shavers stated, used to pay for individual living expenses.").

161 *See, e.g.*, Tiffany L. Minks, Comment, *Ethereum and the SEC: Why Most Distributed Autonomous Organizations Are Subject to the Registration Requirements of the Securities Act of 1933 and a Proposal for New Regulation*, 5 Tex. A&M L. Rev. 405, 422–23 (2018); Oren, *supra* note 118, at 637–38; Robinson, *supra* note 71, at 934.

162 *Common Enterprise*, Black's Law Dictionary (10th ed. 2014); *Joint Enterprise*, Black's Law Dictionary (10th ed. 2014).

163 James D. Gordon III, *Common Enterprise and Multiple Investors: A Contractual Theory for Defining Investment Contracts and Notes*, 1988 Colum. Bus. L. Rev. 635, 651 & nn.111–12. ("The term did appear in three of the post-1934 federal cases cited in *Howey*, but in each case the term is open to conflicting interpretations." (footnotes omitted)). *Howey*, which appeared to be adopting the states' definition of investment contract, cited several state cases, none of which included "common enterprise." *Id.* at 651 & n.110.

164 *See* Madelyn La France et al., *Securities Fraud*, 55 Am. Crim. L. Rev. 1667, 1701 (2018).

165 Gordon, *supra* note 163, at 635–36.

166 *See* La France et al., *supra* note 164, at 1701. Several other definitions of common enterprise also exist. *See* James D. Gordon III, *Defining a Common Enterprise in Investment Contracts*, 72 Ohio St. L.J. 59, 61–62 (2011).

ments."[167] This Section lays out the three major, and two of the minor, tests. Each major test is followed by the loophole that it leaves open.

Horizontal Commonality. Under this test, adopted by the First, Second, Third, Fourth, Sixth, Seventh, Ninth, and D.C. Circuits, for an instrument to be a security, the enterprise must pool multiple investors' funds and the investors' fortunes must rise and fall together.[168] For example, suppose a new graduate asks 10 family members for money to fund a restaurant. Each year, he will take five percent of the total amount initially invested in the restaurant from the restaurant's accounts plus five percent of any profits, and investors will either receive an equal share of the profits or be assessed an equal share of the losses. Here, there is horizontal commonality because the investor funds are pooled, and fortunes are shared equally among investors. *But*, if only one family member is an investor, horizontal commonality is not satisfied because there are not multiple investors. And, if the graduate instead builds ten separate facilities, one for each family member, and keeps each investors' money separated, there is also no horizontal commonality.

Broad Vertical Commonality. Under this test, employed in the Fifth and Eleventh Circuits, the investor's returns must be linked to the promoter's or manager's *efforts*.[169] This effectively incorporates the fourth prong of the *Howey* test into the second prong; if an investor's returns are dependent on a manager's efforts, then the investor expects returns from the managerial efforts of others.[170] Adopting the same hypothetical, both the ten-family-member and one-family-member scenarios will satisfy the vertical requirement because all returns will come from the efforts of the graduate. *But*, because broad vertical commonality effectively reads the fourth prong out of the *Howey* test, which asks whether returns came from the efforts of others, some courts have explicitly refused to adopt it.[171]

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167 Gordon, *supra* note 166, at 77–82.

168 La France et al., *supra* note 164, at 1701–02 & nn.163–65. In some cases, the enterprise must distribute profits pro rata. *See* Gordon, *supra* note 166, at 67 & n.54.

169 La France et al., *supra* note 164, at 1702.

170 *See* Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994) ("If a common enterprise can be established by the mere showing that the fortunes of investors are tied to the efforts of the promoter, two separate questions posed by *Howey*—whether a common enterprise exists and whether the investors' profits are to be derived solely from the efforts of others—are effectively merged into a single inquiry: 'whether the fortuity of the investments collectively is essentially dependent upon promoter expertise.'" (quoting SEC v. Cont'l Commodities Corp., 497 F.2d 516, 522 (5th Cir. 1974))); *infra* Section II.B.4.

171 *See, e.g.*, *Revak*, 18 F.3d at 88.

Narrow (Strict) Vertical Commonality. Under this test, accepted in the Ninth Circuit,[172] the investor's returns must be linked with the promoter's or manager's *returns*.[173] Adopting the hypothetical above, the facts do not satisfy the narrow vertical commonality approach. No matter what happens, the graduate, who is the promoter and manager, benefits; he gets a cut of the original invested sum every year. His fortunes are not tied to his family's. *But*, the family can escape the lack of securities protection by instead sharing profits with the graduate. This appears to be adopted as a *failsafe for the horizontal commonality test*, although no court has explicitly stated as much. This conclusion follows from the fact that no circuits employ this test exclusively, and its impact is thus reserved to cases where funds are not pooled.[174]

Each approach is flawed. The first fails to protect those caught up in pyramid schemes or swindled by con artists who promise the world, as long as the schemer or swindler does not pool assets of more than one investor.[175] The second sweeps in investment advisors and other professionals who operate on commission and on whom investors rely—not to mention the problem with the nullification of *Howey*'s fourth prong.[176] And the third method allows a promoter to game the system to avoid securities laws by ensuring that his fortunes are not directly correlated with investors', which is easily achievable by enacting a fixed commission system.[177] Other approaches attempt to resolve these downsides.[178]

Hybrid Systems. The Ninth Circuit has applied both horizontal and strict vertical commonality to protect those whose investments are not pooled and those who suffer from clever commission-based frauds,[179] and the First, Second, Third, Fourth, and D.C. Circuits may

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172 La France et al., *supra* note 164, at 1702. The First, Second, Third, Fourth, and D.C. Circuits have not reached the issue. Courts in the Eighth Circuit have used a variety of these approaches, and the Eighth Circuit Court of Appeals has not conclusively weighed in. *See id.* at 1702–03.

173 *Id.* at 1701–02.

174 *See id.* at 1701–03.

175 *See, e.g.*, Loss & Seligman, *supra* note 154, at 251–52.

176 *See, e.g.*, *id.* at 252; *supra* note 170 and accompanying text.

177 *See, e.g.*, Loss & Seligman, *supra* note 154, at 253; *supra* notes 173–74 and accompanying text.

178 *See* Gordon, *supra* note 163, at 636.

179 *See supra* text accompanying notes 168, 172–73.

be willing to do the same.[180] This is the preferred system of Professors Loss and Seligman.[181]

Economic Reality. Under this test, used most notoriously in the Tenth Circuit, the court simply asks whether the "transaction [was] purely commercial in nature (for example, a commercial loan or a sale of assets)" or the "transaction [was] in reality an investment (that is, a transaction of a type in which stock is often given)."[182] If the transaction falls in the latter category, it is a common enterprise.[183]

To paraphrase, because one test is generally used only as a failsafe, circuits determine whether something is a common enterprise by asking whether (1) the enterprise pooled funds and investors' fortunes rose and fell together, or (2) the investors' fortunes depended on the efforts of a promoter or manager. And some argue that courts should look at the economic reality and ask whether (3) a transaction resembled a stock transaction.[184]

Unfortunately, a consensus has not emerged from the ink spilled,[185] and no response from the Supreme Court appears to be forthcoming.[186] The Court has implied that formalism employed by courts and commentators should give way to a pragmatic test of substance, but it has never expressly discussed the meaning of a common enterprise.[187] Given the discord, when analyzing a particular situation, looking through each lens is important.

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180 *See supra* note 172.

181 LOSS & SELIGMAN, *supra* note 154, at 253.

182 McGill v. Am. Land & Expl. Co., 776 F.2d 923, 925 (10th Cir. 1985) (noting that the court was basing its decision in its perception of "economic reality").

183 *Id.* In practice, this system closely resembles the method proposed by James Gordon, which he terms the "multiple investors" test. This test would protect those in pyramid schemes as long as there were others in the same schemes even where funds were not pooled, and it would properly promote the disclosure policy of the Securities Acts. *See* Gordon, *supra* note 166, at 62.

184 *See supra* text accompanying notes 182–83.

185 *See* LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES REGULATION 147 (8th ed. 2014) (examining the patchwork of circuits applying each test and noting that "[u]nless the Supreme Court decides between the vertical-horizontal approaches, confusion will likely continue").

186 This conclusion is drawn from the simple fact that in the 23 years between publishing articles examining the common enterprise element in depth, one scholar's in-depth analysis demonstrates that if the complexity of the situation has changed at all, it has changed for the worse. *Compare* Gordon, *supra* note 163, at 635, 651 & nn.110–112 ("'[C]ommon enterprise' . . . is open to conflicting interpretations."), *with* Gordon, *supra* note 166, at 61–62 (asserting that federal circuit courts remain "fractured" on the issue of the correct definition for "common enterprise").

187 *See* SEC v. Edwards, 540 U.S. 389, 393 (2004) ("'Congress' purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called.' To that end, it enacted a broad definition of 'security,' sufficient 'to encompass virtually any instrument that might be sold as an investment.'" (citation omitted) (quot-

Applying the Common Enterprise Tests to ICOs. Utility tokens appear to bring buyers within a common enterprise. But this step divides commentators. Both Primalbase and The DAO help illustrate the debate.

Take the first the case of Primalbase.[188] Once Primalbase's offices opened, tokenholders or lessors could gain admission to offices with tokens, but, before the offices were open, the tokens had no practical utility.[189] These tokens could be traded on markets, however.[190] Because of this, under each commonality test, Primalbase is a common enterprise. In horizontal commonality, the enterprise must pool user funds, and investor fortunes must rise and fall together. Primalbase pooled tokenholder funds to fuel its development and create its distributed network, and its tokenholders' fortunes rose and fell together because the tokens' value fluctuated to match the market price established by those speculating as to the value of Primalbase's future services.[191] In broad vertical commonality, the investor's returns must be dependent on the promoter or manager's efforts.[192] These investors would gain or lose money on their investments based on Primalbase bringing its product to the market, which was developed and managed by a centralized company, not by the tokenholders.[193] Finally, the economic reality test demonstrates that this was a stock-like transaction: people excited about an idea invested money in it and received tokens that would be valuable in the future if the enterprise succeeded.[194] If the enterprise failed, their tokens would be worthless. And the more

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ing Reves v. Ernst & Young, 494 U.S. 56, 61 (1990))); Gordon, *supra* note 166, at 82 (proposing a test that "corresponds to commonsense notions about which instruments Congress intended to reach under the [S]ecurities [A]cts").

188 *See supra* Section I.C.

189 *See supra* Section I.C.

190 Trading began in the market no more than one month after the ICO. *See Primalbase Token*, *supra* note 64 (showing market trading occurred as early as September 2017). Its first proof-of-concept office opened three months later in Amsterdam on October 12, 2017. Primalbase Team, *Primalbase AMS, the Amsterdam Office*, MEDIUM (Dec. 28, 2017), https://medium.com/primalbase/primalbase-the-amsterdam-office-f48e105728bf [https://perma.cc/R477-TTXG].

191 That these prices moved based on the outcomes of the company relies on the assumption of an at least partially efficient market. *See* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 554–88 (1984).

192 *See supra* notes 169–71 and accompanying text.

193 As noted above, Primalbase tokenholders received the right to use offices, not the right to manage the company. *See supra* note 66 and accompanying text.

194 *See supra* notes 140–44 and accompanying text.

successful the company, the more in-demand its tokens will be, which may cause increases and decreases in token value.[195]

But moving to The DAO, the picture seems to blur. DAO tokenholders belong to an organization that votes democratically for contracts and splits revenue; commentators note that this sounds a lot like a partnership.[196] But pausing to consider the fundamentals of The DAO's ICO clarifies any confusion. Horizontal commonality is obvious from The DAO's structure. All of the tokenholders get a proportional share of profits from investments made out of The DAO's common pool of funds.[197] Vertical commonality is also clear after reviewing The DAO's beginnings. Investors relied on the organization's designers' efforts in launching the platform, setting up repositories for DAO funds, creating a curator system to attempt to avert fraud, and, ultimately, to come up with a resolution when one-third of the total DAO funds were stolen.[198] Lastly, this is another transaction that looks like a stock purchase. Investors bought into a proof of concept that they hoped would turn into a scalable world-changing technology, and they hoped to make some money in the process.[199] The parallel to modern venture-capital funding is obvious, and those venture-capital funds primarily buy one thing: stock.[200]

Still, proponents of The DAO argue that its interests were not securities because no one person was a manager or promoter, and, thus, there was no possibility of vertical commonality.[201] But this relies on a flawed premise. Although the ultimate goal was to have a headless organization operating as a pure democracy, this was not the reality at its launch. The DAO's creator, Christoph Jentzsch, worked with his company, Slock.it, to develop the concept and garner support from an online community.[202] Slock.it organized the selection of curators to prevent malicious contracts from harming The DAO.[203] And only 18

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195 *See supra* note 191.

196 *See* Oren, *supra* note 118, at 651; *see also* Dirk A. Zetzsche et al., *The Distributed Liability of Distributed Ledgers: Legal Risks of Blockchain*, 2018 U. ILL. L. REV. 1363, 1399–400 (examining the circumstances when a distributed autonomous organization might be subjected to partnership liability under civil and common law jurisdictions).

197 The DAO Report, *supra* note 17, at 5–6.

198 *See id.* at 12–13; *supra* text accompanying note 75.

199 *See supra* note 143 and accompanying text.

200 *See, e.g.*, Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1072 & n.14 (2003).

201 Oren, *supra* note 118, at 639–41; Robinson, *supra* note 71, at 937–40.

202 *See* Jentzsch, *supra* note 73.

203 *See id.* The DAO white paper stated that The DAO's structure "[gave] the [c]urator of a DAO considerable power." JENTZSCH, *supra* note 60, at 2.

developers, who could rightly be called managers or promoters, ultimately designed the entire system.[204]

One scholar also asserts that there was no horizontal commonality, arguing that all investors' fortunes did not rise and fall together. He argues that tokenholders were free to reject majority-approved new contracts by forming new, separate DAOs with the consolidated funds of the objectors. This means that the objectors' fortunes would not rise and fall with nonobjecting investors', destroying horizontal commonality.[205] But this new DAO (and every new subdivided DAO) would then have its own pool of funds, and its investors' fortunes would rise and fall together, satisfying horizontal commonality. Horizontal commonality does not demand that the company that issues a security never split for it to be considered a security.

Commentators also put forward arguments that there was no strict vertical commonality.[206] This misses a practical point: no court employs only strict vertical commonality.[207] Doing so would allow any enterprise to avoid securities regulation by refraining from pooling assets. Because DAO tokens satisfy the other tests, courts should uniformly hold them to be investments in a common enterprise under *Howey*.

3. With the Expectation of Profits

The Supreme Court has refined and simplified the profit prong to the following: Does the instrument holder have "a reasonable expectation of profits"?[208] Regarding the reasonable expectations, courts heavily weigh promoters' representations to potential investors, considering promises of returns or representations that an investment is

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204 *See* Jentzsch, *supra* note 73. It has also been argued that The DAO may not have satisfied the vertical tests because its promoters were not "experts." *See* Minks, *supra* note 161, at 423. First, the test does not require that the promoters be experts, only that investors rely on their efforts. Second, The DAO's coders had sufficient expertise to build The DAO; it is unlikely that some requisite high level of expertise is needed as this test could be easily circumvented by promoters who know nothing, perhaps the most dangerous kinds of promoters.

205 Robinson, *supra* note 71, at 936–37.

206 *See id.* at 939–40.

207 *See supra* text accompanying note 174.

208 United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852–53 (1975) (holding that shares that could not appreciate in value of a housing cooperative could not induce a holder to reasonably expect profits from the shares); *see also* Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 561–62 (1979) (holding that earnings of a pension plan are too attenuated from the exchange for employee labor to give rise to a reasonable expectation of profit by the employee, who is primarily concerned with meeting vesting requirements not investment performance). This flexible test will not be satisfied when the profit motive is negligible. HAZEN, *supra* note 120, § 5, at 30 (citing *Daniel*, 439 U.S. 551).

low risk that fuel reasonable expectations of profits.[209] These profits are the investor's profits, not the enterprise's profits, and they can be any income or returns to be derived from the enterprise, including dividends, periodic payments (including fixed payments), or "*the increased value of the investment*."[210] When investors reasonably expect that they will receive some increased financial value, be it actual rights to dividends or simply an increased value as measured by a trading market, that expectation will satisfy the third prong of *Howey*.[211]

This condition is met with both Primalbase and DAO tokens. Primalbase, in its statement after the closing of its ICO, a tiered-price offering,[212] plainly said that it would continue further development "to help increase the value of [its token] for existing investors," conveying that investors could reasonably expect profit because the token's value would appreciate.[213] The case with The DAO is even more straightforward. Its premise was investing its pooled assets to earn money, thereby increasing the value of DAO tokens.[214] This prong requires nothing more.

4. From the Efforts of Others

Missing from the heading is the word "solely" used in *Howey*. That is intentional. If an entrepreneur mistakes "solely" as part of the law today, she may unexpectedly find herself on the wrong side of the SEC because the Supreme Court's fourth prong is better summed up in a more recent case: *United Housing Foundation, Inc. v. Forman*.[215] The investment contract test now requires that profits simply be derived "from the entrepreneurial or managerial efforts of others."[216]

Although the facts in *Howey* did not give occasion to consider profits not solely from the efforts of others, a strict reading of *Howey* would leave an enormous loophole. Any effort, however small, by an investor would preclude the classification as an investment contract.[217]

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209 *See* SEC v. Edwards, 540 U.S. 389, 394 (2004) (finding that phone-service promoter promises that there would be profits from installing pay phones and that an investment was "low risk" substantiated investors' reasonable expectations of returns).

210 *Id.* (emphasis added).

211 *See id.*

212 *See supra* notes 140–44 and accompanying text. This type of price offering innately gives rise to a reasonable expectation of profit for early investors. It exists to persuade investors to invest early, thereby securing nearly instant returns, satisfying this prong.

213 Brandon, *supra* note 138.

214 *See supra* text accompanying notes 70–71.

215 421 U.S. 837 (1975).

216 *Id.* at 852.

217 *See* SEC v. Glenn W. Turner Enters., 474 F.2d 476, 482 (9th Cir. 1973).

Courts agree: at least ten circuit courts have reinterpreted the requirement to encompass instances where "essential managerial efforts [of others] . . . affect the failure or success of the enterprise."[218]

In the case of Primalbase, profits will not accrue to tokenholders unless the Primalbase workspace network, a system being managed and developed solely by Primalbase, succeeds.[219] This means that in practice the business cannot succeed, and therefore profits cannot therefore accrue, without supervisors managing the entrepreneurial coders and development of co-working properties, rendering these managers' efforts "essential." All tokens that can profit only from the success of a centralized development team, like Primalbase, will satisfy this prong.

For The DAO, recall from the discussion of the vertical commonality test that broad vertical commonality essentially merges with the "efforts of others" prong.[220] The DAO had thousands of members, and it had a small core group of curators and coders.[221] In addition, its profits were to be gained based on the execution of coded contracts, which would be carried out across a network of computers, designed by groups or individuals.[222] The (purely optional) responsibilities of tokenholders were simply to review the contracts and vote, leaving the design and execution to contract designers and the screening to curators.[223] Without those enterprising contract designers, there would be no opportunity for profit, and without curators screening contractors authorized to receive DAO funds, devious contract designers could attempt to integrate code that would simply move DAO funds to a private cryptocurrency wallet.[224] It is difficult to make a commonsense argument demonstrating that contractors, curators, and coders are not the people exerting the essential efforts.

Addressing Counterarguments. The increasingly common argument that essential efforts are made by tokenholders, not those that set up and maintain these platforms, appears in Professor Randolph Robinson II's article *The New Digital Wild West: Regulating the Explosion of Initial Coin Offerings* and Ori Oren's note laying out a proposal for a partnership structure for distributed autonomous

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218 *E.g.*, *id.*; *see also* Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 240 n.4 (4th Cir. 1988) (collecting cases).

219 *See supra* note 193 and accompanying text.

220 *See supra* note 170 and accompanying text.

221 *See supra* notes 202–04 and accompanying text.

222 *See, e.g.*, JENTZSCH, *supra* note 60, at 1–2.

223 *Id.* at 2–3.

224 *See id.* at 2.

organization. Robinson argues that because curators do not play a role in reviewing contracts themselves or deciding which contracts go forth, all of the power of the enterprise is vested in the tokenholders, who function as partners in the enterprise.[225] He argues that both Slock.it and The DAO's curators exercised virtually no control or managerial effort, adding that tokenholders had the power to remove and replace curators at any time.[226] But this is far from the test for essential managerial efforts and offers only a limited view of "the efforts of others" in The DAO. Corporate shareholders may also vote to remove directors or even dissolve the corporation,[227] but that does not demonstrate that these shareholders (who are obviously security holders under the Securities Acts) do not rely on essential managerial efforts of directors or other people within the corporation to generate profits. It simply demonstrates that shareholders disapprove of those managerial efforts.

Without the approval of DAO contractors by the efforts of curators, no contractor could ever receive funds, and, thus, no tokenholder could ever receive profits.[228] Although The DAO's organizers noted that curators would not provide any merit review or screening for individual contracts,[229] its founding white paper reveals an important fact: "the [c]urator of a DAO [is given] considerable power."[230] Robinson also does not address the argument above that the profits are also dependent on the managerial efforts of those who create contracts for The DAO to execute, who appear to be the primary profit drivers of the enterprise.[231]

In his note laying out a proposal for a partnership structure for distributed autonomous organization, Oren comes to the same conclusion as Professor Robinson.[232] Seizing on the SEC's imperfect analysis that Slock.it, its cofounders, and The DAO's curators were essential to the enterprise, Oren argues that their efforts were ministerial and not managerial, leaving the "essential" managerial power to tokenholders.[233] This argument is subject to at least two criticisms: First, this

225 Robinson, *supra* note 71, at 940–48.

226 *Id.*

227 HAAS, *surpa* note 59, § 3.02[1][a], [f].

228 JENTZSCH, *supra* note 60, at 2.

229 Robinson, *supra* note 71, at 942–43.

230 JENTZSCH, *supra* note 60, at 2.

231 *See id.* at 3–9 (describing the process by which The DAO selects contractors, sends funds, and receives proceeds).

232 *See* Oren, *supra* note 118, at 642–51.

233 *Id.*

ignores that the efforts of Slock.it, The DAO's initial coders, and its curators were essential to making profit during the ICO.[234] Without these groups, there could not have been investment into The DAO.

Second, investors were required to trust that the initial creators of The DAO properly safeguarded assets and did not hide malicious code. For their investments to have any value, those efforts were essential.[235] The question remains whether right-granting instruments in an organization that functions on a wholly egalitarian governance system where all participants are, in fact, entitled to equal control will be securities. As demonstrated here, however, that was not the case with The DAO.

Both Robinson and Oren note that DAO tokens functioned like partnership interests and attempt to distinguish them from the partnership interests in *Williamson v. Tucker*.[236] *Williamson* was a Fifth Circuit case that held that purported general partnership shares could be designated securities if any of three conditions were satisfied, demonstrating that the shareholder depended on others.[237] The share may be a security where (1) an agreement leaves so little power with the partner that she in fact has only the power of a limited partner, (2) the partner lacks experience or knowledge in business such that she cannot intelligently exercise partnership powers, or (3) the partner is so dependent on the entrepreneurial or managerial skill of the promoter that she cannot replace him or "otherwise exercise meaningful partnership . . . powers."[238]

This test demonstrates the risk of The DAO. Under the second prong, the most plainly problematic, an interest holder without experience or knowledge of a business may be designated as the holder of a security.[239] The DAO did not restrict its interests to only investors with business experience or the capacity to understand the business of The DAO.[240] Conceptually, such a partnership could exist. For example, partnerships with up to several thousand partners, like large law firms, can be close analogues[241] because, unless the partnership agreement

234 *See supra* text accompanying notes 228–30.

235 *See supra* text accompanying note 224.

236 645 F.2d 404 (5th Cir. 1981); *see* Oren, *supra* note 118, at 650–51; Robinson, *supra* note 71, at 944–48.

237 *Williamson*, 645 F.2d at 424.

238 *Id.*

239 *Id.*

240 The only requirement for receiving DAO tokens was a contribution of cryptocurrency to The DAO. The DAO Report, *supra* note 17, at 6.

241 This is an imperfect analogy because most law firms are intentionally structured as lim-

concentrates voting power with only a few attorneys, no one partner holds significant voting power.[242] But in a large law firm, for example, every partner has business and legal experience.[243] The fact that there were thousands of members who were not prescreened in The DAO suggests that there were free riders who did not have the necessary experience to intelligently exercise "partnership . . . powers."[244] This is precisely the condition that calls for SEC regulation. Without any knowledge of the business, tokenholders' fortunes are at the mercy of their experienced and intelligent peers.[245] This calls for disclosure, which securities regulation requires.[246]

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The most critical language in *Howey* sums up the investments that Congress intended to regulate with the Securities Acts' definition of a security: "It 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."[247] The newest variation of these schemes in recent years is the token.

III. Deferring to the SEC

Those that believe that the SEC's interpretation of tokens as securities was wrong may still concede that it is *reasonable*. Given courts' practice of deferring to agency legal interpretations of ambiguous statutory commands, perhaps courts must nonetheless accept the SEC's interpretation over the objectors.[248] This argument was recently put forth by Professor Steven Cleveland, who argued that the Securi-

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ited partnerships, but many retain general partnership structures. *See, e.g.*, *The Value of a True Partnership*, Jones Day, https://www.jonesday.com/atruepartnership/.

242 *See General Partnership*, Black's Law Dictionary (10th ed. 2014) (defining a general partnership as "[a] partnership in which all partners participate fully in running the business and share equally in profits and losses").

243 In large law firms, the path to partner generally involves years of training in legal practice under partners and other experienced attorneys. *See, e.g.*, Frederick L. Trilling, *The Strategic Application of Business Methods to the Practice of Law*, 38 Washburn L.J. 13, 32–33 (1998).

244 *Williamson*, 645 F.2d at 424.

245 *See id.*

246 Although there are several arguments for and against satisfaction of the first and third *Williamson* prongs, they fall outside the scope of this Essay.

247 SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

248 *See* Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984).

ties Acts' definitions of a security were, in fact, ambiguous and that, as a result, related SEC interpretations deserved deference.[249]

A. A Concise History of Securities Regulation Deference

Examining Supreme Court precedent, Cleveland concluded that the Court has moved away from the deference given by many courts to the SEC when determining what constitutes a security.[250] A brief survey of case law does not readily support this conclusion. In *International Brotherhood of Teamsters v. Daniel*,[251] the case on which Cleveland relies for his assertion that courts historically gave great weight to SEC security determinations,[252] the Court noted that consistent, longstanding agency interpretations of their own governing statutes receive deference.[253]

But the *Daniel* Court expressly rejected deferring to the SEC's determination that an instrument constituted a security, observing that the statutory provision defining a security had a clear meaning and illustrating the Court's historical lack of deference by citing six instances in the prior decade where the Court had rejected SEC interpretations of its own governing statutes.[254] Flawed historical underpin-

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249 Steven J. Cleveland, *Resurrecting Court Deference to the Securities and Exchange Commission: Definition of "Security,"* 62 CATH. U. L. REV. 273, 275–77, 302–03 (2013).

250 *Id.* at 274–76 ("[B]efore *Chevron*, courts accorded great weight to the SEC's interpretation of whether a financial instrument constituted a 'security[]' . . . . Recently, without explanation, the Court has seemingly deviated from its precedent favoring deference to the SEC's interpretation of statutory ambiguity.").

251 439 U.S. 551 (1979).

252 *See* Cleveland, *supra* note 249, at 275 n.7.

253 *Daniel*, 439 U.S. at 566 n.20. In that footnote, the Court referred to several logical predecessors to *Chevron* that held or noted that agencies received deference, but none involved SEC security determinations. *See* United States v. Nat'l Ass'n of Sec. Dealers, 422 U.S. 694, 719 (1975) (noting that longstanding SEC interpretation of broker-dealer statute was entitled to "considerable weight"); Saxbe v. Bustos, 419 U.S. 65, 74 (1974) (noting that an Immigration and Naturalization Service interpretation of an immigration statute was entitled to great weight, especially after Congress revised the statute at issue an did not alter the terms interpreted by the agency); Inv. Co. Inst. v. Camp, 401 U.S. 617, 626–27 (1971) (analyzing a regulation promulgated by the Comptroller of the Currency and stating that "[i]t is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute"); Udall v. Tallman, 380 U.S. 1, 16–17 (1965) (noting in a case regarding deference to longstanding interpretations by the Secretary of the Interior of statute governing the Department of the Interior that those positions receive "great deference").

254 *Daniel*, 439 U.S. at 566 n.20 (citing SEC v. Sloan, 436 U.S. 103, 117–19 (1978); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 41 n.27 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212–14 (1976); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 n.25 (1975); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 759 n.4 (1975) (Powell, J., concurring); Reliance Elec. Co. v. Emerson Elec. Co., 404 U.S. 418, 425–27 (1972)).

nings aside, Cleveland's argument raises several valid points supporting deference to the SEC. Three are noted below.

The first is the ambiguous definition of a security.[255] Although the Court has not stated in recent cases that the Securities Acts' definition of a security is ambiguous, many scholars and courts agree that it is.[256] Additionally, in several cases the Supreme Court has discussed the definition of a security and implied that the statutes' definition contains ambiguity, although it has never used that term.[257] In *Reves*, the Court explained that Congress chose an indeterminate definition "at the expense of the goal of clarity" to "permit[] the SEC . . . sufficient flexibility to ensure that those who market investments are not able to escape the coverage of the Securities Acts by creating new instruments that would not be covered by a more determinate definition."[258] Stopping shy of saying explicitly that the statute was ambiguous, the Court simply said that Congress's broad, sweeping definition and lack of goal "clarity" was a problem for Congress, not the Court, to fix.[259]

This ambiguity is important because of its important role in the famous two-part framework, established by *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* ("*Chevron*"),[260] that courts apply when deciding whether deference to an agency's legal conclusion is warranted. First, "applying the ordinary tools of statutory con-

255 Cleveland, *supra* note 249, at 274–75.

256 *See, e.g.*, Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230, 238 (2d Cir. 1985) ("The definitions of 'security' are broad and ambiguous."); Robert Anderson IV, *Employee Incentives and the Federal Securities Laws*, 57 U. MIAMI L. REV. 1195, 1198 n.17 (2003) (discussing the "muddy" outer boundaries of what constitutes a security) (quoting Scott FitzGibbon, *What is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 MINN. L. REV. 893, 895 (1980)); J. Thomas Hannan & William E. Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L.J. 219, 219 (1974) ("The definition of the term 'security,' as used in the principal federal securities laws, is for the most part one of the best kept secrets in recent legal history."); Michael C. Macchiarola, *Securities Linked to the Performance of Tiger Woods? Not Such a Long Shot*, 42 CREIGHTON L. REV. 29, 45 (2008) (calling ambiguities in the Securities Acts "inherent and, perhaps, intentional").

257 *See, e.g.*, Reves v. Ernst & Young, 494 U.S. 56, 61 (1990) ("Congress . . . did not attempt precisely to cabin the scope of the Securities Acts."); Marine Bank v. Weaver, 455 U.S. 551, 559 (1982) (holding that an instrument not enumerated in the Securities Acts was not a security because it was not "the type of instrument that comes to mind when the term 'security' is used and does not fall within 'the ordinary concept of a security.'" (quoting H.R. REP. NO. 73–85, at 11 (1933))); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943) (noting that "[n]ovel, uncommon, or irregular devices" are securities if "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."'").

258 *Reves*, 494 U.S. at 63 n.2.

259 *Id.*

260 467 U.S. 837, 842–43 (1984).

struction, the court must determine 'whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.'"[261] Second, where a statute is silent or ambiguous regarding the issue, the court must assess "whether the agency's answer is based on a permissible construction of the statute," that is, whether it is reasonable.[262] In the context of the Securities Acts, the ambiguities above signal that the Acts' definition of a security is ambiguous (apart from the obvious enumerated categories). A court holding the same would then proceed under a full *Chevron* analysis.[263]

Second, Cleveland argues that deciding the reach of the definition of a security requires policy decisions best left to the political branches.[264] Justice Scalia, writing for the Supreme Court around the same time that Cleveland's article went to print, came to the same conclusion in *City of Arlington v. FCC*:[265]

> "Congress, when it left ambiguity in a statute" administered by an agency, "understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the

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261 City of Arlington v. FCC, 569 U.S. 290, 296 (2013) (quoting *Chevron*, 467 U.S. at 842–43). In *Chevron*, the Court also noted that "it would appear that the listing of overlapping, illustrative terms was intended to enlarge, rather than to confine, the scope of the agency's power to regulate particular sources in order to effectuate the policies of the Act," a factor surely present in Section 77b(a)(1). *Chevron*, 467 U.S. at 862; *see* 1919 Minn. Laws 99, 101–02.

262 *Chevron*, 467 U.S. at 843.

263 This assumes the court also held that the SEC's interpretation was *Chevron*-eligible under *United States v. Mead Corp.*, 533 U.S. 218, 226–27 (2001). Objectors might argue that the Securities Act defined security before the *Chevron* doctrine became settled law. Assuming for the sake of argument that deference was not the standard practice of court before *Chevron*, Congress has amended the definitions portion of the Securities Act at least six times since the case was decided, making a finding of implicit delegation in light of *Chevron* more justified. *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 105, 126 Stat. 306, 310 (2012); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 768, 124 Stat. 1376, 1800 (2010) (specifically altering the definition of a security); Consolidated Appropriations Act of 2001, Pub. L. No. 106-554, § 208, 114 Stat. 2763, 2763A–434 to –435 (2000) (specifically altering the definition of a security); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 301, 112 Stat. 3227, 3235 (1998); National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 106, 110 Stat. 3416, 3424 (1996); Securities and Exchange Commission Authorization Act of 1987, Pub. L. No. 100-181, §§ 201–02, 101 Stat. 1249, 1252 (1987). The question whether a court should proceed through the analysis under *Mead* is complex and better reserved to dedicated previous analyses. *See generally, e.g.*, Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187 (2006) (discussing *Chevron* and its interactions with *Mead* doctrine).

264 Cleveland, *supra* note 249, at 283; *see also* Sunstein, *supra* note 263, at 243 (arguing that Congressional delegations should be interpreted by politically accountable agencies, not courts).

265 569 U.S. 290 (2013).

> agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows." . . . Statutory ambiguities will be resolved, within the bounds of reasonable interpretation, not by the courts but by the administering agency.[266]

The Court explained that allowing courts to overrule reasonable agency interpretations would tempt judges into "making public policy by prescribing the meaning of ambiguous statutory commands [and] . . . 'substituting their own interstitial lawmaking' for that of an agency," contravening *Chevron*.[267]

This provides a strong precedent for court deference to the SEC when considered in light of the Court's conclusion in *Reves* that "security" lacks a "determinate definition" and that any clarification must come from Congress, not the courts.[268] Under *City of Arlington*, the SEC, as the administering agency of the Securities Acts, is the agency that should "possess whatever degree of discretion" allowed by the ambiguity in § 77b(a), the definition of a security in the Securities Act.[269]

Third, Cleveland points out an enormous challenge that federal regulation faces when courts do not defer to agency positions: circuit splits.[270] Circuit splits have a particularly visible effect in securities regulation, which is owed to two words from *Howey*: common enterprise.[271] Because circuits have independently developed the *Howey* test's prongs, companies and investors can face different protections and burdens based on location. Of course, if the SEC were owed def-

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266 *Id.* at 296 (citation omitted) (quoting Smiley v. Citibank (S.D.), N.A., 517 U.S. 735, 740–41 (1996)).

267 *Id.* at 304–05 (quoting Ford Motor Credit Co. v Milhollin, 444 U.S. 555, 568 (1980)). Justice Scalia, true to form, did not mince words in his recognition that *City of Arlington* was a covert attempt to rein in *Chevron*:

> The false dichotomy between "jurisdictional" and "nonjurisdictional" agency interpretations may be no more than a bogeyman, but it is dangerous all the same . . . . Make no mistake—the ultimate target here is *Chevron* itself. Savvy challengers of agency action would play the "jurisdictional" card in every case . . . . The effect would be to transfer any number of interpretive decisions . . . from the agencies that administer the statutes to federal courts.

Id. at 304 (footnote omitted) (citation omitted).

268 *See supra* text accompanying note 258.

269 *See City of Arlington*, 569 U.S. at 296. Notably, Professor Cleveland spent a significant portion of his article arguing that the distinction between executive and independent agencies cuts against the rationale for deference because independent agencies are less politically accountable than their executive counterparts. Cleveland, *supra* note 249, at 293–97. *City of Arlington* conclusively resolved this; as its caption implies, the Court granted deference to an independent agency, the FCC. *See City of Arlington*, 569 U.S. at 307.

270 *See* Cleveland, *supra* note 249, at 282.

271 *See* discussion *supra* Section II.B.2 (describing the different circuit approaches).

erence, it could establish a uniform interpretation to put Humpty Dumpty back together.[272]

Because no courts have addressed the definition of a security in the *Chevron* framework, likely in part due to longstanding flexible court precedent on what constitutes a security, the question of whether the SEC is owed deference has remained largely theoretical, with only tangential historical support.[273] But recent developments, namely, the rise of ICOs, may herald the beginning of a new era of SEC regulation.[274]

B. A Case for Deference

New blockchain-based companies spring up every day, and ever since the launch of The DAO, they are increasingly taking varied and complex forms.[275] These companies promise exciting innovations, and several projects have delivered on these innovations.[276] But the fundraising methods used by these companies are nothing new, and the SEC should receive the deference that it needs to effectively regulate tokens carefully designed and sold in manners that attempt to evade securities regulation.

In the EOS token sale, Block.one sold tokens under a purchase agreement[277] that appears on its face to be invalid for lack of consideration.[278] Block.one expressly stated that its EOS tokens "have no rights, uses, purpose, attributes, functionalities or features, express or implied," and could not be used on the EOS platform, which was not

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272 Or, as noted above, the SEC could adopt the commonsense "economic reality" or "multiple investor" tests that appear to underlie the Court's jurisprudence. *See supra* notes 182–83 and accompanying text.

273 That historical support is found in the Minnesota case heavily relied on in *Howey*, *State v. Gopher Tire & Rubber Co.*, 177 N.W. 937 (Minn. 1920), which suggested that an agency dedicated to securities enforcement has some special knowledge of what bizarre instruments might constitute securities. *See Gopher Tire & Rubber Co.*, 177 N.W. at 938 ("The commission is better qualified than the average investor to ascertain whether any real values lie behind mere paper evidences of value.").

274 *See supra* INTRODUCTION.

275 *See, e.g.*, Andrew Rossow, *Top 10 New Blockchain Companies to Watch for in 2018*, FORBES (July 10, 2018, 9:32 AM), https://www.forbes.com/sites/andrewrossow/2018/07/10/top-10-new-blockchain-companies-to-watch-for-in-2018/#2c230a7f5600 [https://perma.cc/5ZXA-KVBN] (noting token sales by companies restructuring marketing, lending, and media content distribution, among other things).

276 *See, e.g.*, *How It Works*, *supra* note 66 (describing how the innovative token-based business model works).

277 *See* EOS TOKEN PURCHASE AGREEMENT, *supra* note 11.

278 *See generally* Hamer v. Sidway, 27 N.E. 256 (N.Y. 1891) (defining consideration and the consideration requirement for a valid contract).

available when the tokens were sold anyway.[279] Of course, this did not stop investors from buying over $4 billion in EOS tokens.[280] And although the token sale was restricted to investors outside of the United States,[281] investors could trade EOS tokens on coin exchanges, where, as of this writing, daily trade volume regularly exceeds $500 million.[282] Once U.S. citizens obtain EOS tokens, Block.one does not restrict them from using the EOS system.[283] Now, developers and hobbyists across the United States can trade these tokens on the EOS network.[284]

It is hard to fathom that Block.one represented that its tokens had no value and no functionality in good faith. And those familiar with ICOs recognize Block.one's purchase agreement representations as legal formalism.[285] The SEC, with its own unit dedicated in part to dealing with ICOs, has the expertise to determine when these masked securities transactions take place.[286]

Those who adopted the Securities Acts attempted to regulate anything that *might* be an investment.[287] Given the arguable ambiguity outlined in the previous Section, the SEC, the agency regulating securities day in and day out, can best conceptualize what in this new field is a security. And with new ICOs launching every day,[288] the test that the SEC applies will likely need more flexibility than a once-per-decade Supreme Court opinion can offer.

This has two obvious benefits. First, this would resolve the legal ambiguity that cryptocurrency lawyers and businesses have dwelled in

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279 EOS TOKEN PURCHASE AGREEMENT, *supra* note 11, at 8.

280 *See supra* text accompanying notes 2–3.

281 EOS TOKEN PURCHASE AGREEMENT, *supra* note 11, at 1–2.

282 *EOS*, *supra* note 83.

283 *See* u/Molfzartc0inz, *EOS United States Registration*, REDDIT: R/EOS (Apr. 27, 2018, 9:16 PM), https://www.reddit.com/r/eos/comments/8fgl7a/eos_united_states_registration/ [https://perma.cc/T7GH-C5EB] (discussing anticipated access to EOS platform in the United States).

284 *See* Jenkinson, *supra* note 80.

285 *See* Bradley, *supra* note 13 ("This is most likely to separate legal risk from the company. Once the software is ready, they can have anyone, in any jurisdiction, launch it from their basement. The genesis block will (most likely) reflect a 1 for 1 distribution of ERC20 tokens to EOS tokens . . . . Government regulations give very little choice . . . . This type of thing has happened successfully many times before . . . .").

286 *See* SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors, U.S. Sec. & Exch. Comm'n (Sept. 25, 2017), https://www.sec.gov/news/press-release/2017-176 [https://perma.cc/E6HM-K75M].

287 "[Congress] enacted a broad definition of 'security,' sufficient 'to encompass virtually any instrument that *might* be sold as an investment.'" SEC v. Edwards, 540 U.S. 389, 393 (2004) (emphasis added) (quoting Reves v. Ernst & Young, 494 U.S. 56, 61 (1990)).

288 *See supra* text accompanying note 38.

by giving the power to make public policy decisions about securities to the agency that was meant to make them. After *City of Arlington*, the case for deference to the SEC's definition of a security based on this rationale has become clearer.[289] As that case made clear, if Congress thinks that a reasonable interpretation is still wrong, it can pass a bill to correct the issue.[290] Tokens of decentralized autonomous organizations whose members are active and qualified in business,[291] especially, will present novel issues with unclear results under the *Howey* test. Whether and how to promote and regulate these organizations will likely require quick action; these organizations are raising billions of dollars per year.[292] Courts are simply not as well qualified to handle this detailed and fast-changing business.

Second, establishing deference to the SEC will permit a uniform standard across the country rather than a circuit-by-circuit approach. Because ICOs are internet-based and therefore inherently interstate, rendering them amenable to federal regulation,[293] this will prevent multifarious tests from being applied to securities questions that occur in many jurisdictions. This benefit accrues not only to the SEC but also to the regulated. Commentators calling for regulation recognize the challenges of the "Digital Wild West," but courts should be wary of replacing the relative anarchy with patchwork regulation.[294] Deferring to the SEC will accomplish this goal.[295]

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289 Of course, *City of Arlington* was decided before Justice Gorsuch, a likely vote against broad administrative power, took the bench. *See* Aaron L. Nielson, Response, *Confessions of an "Anti-Administrativist,"* 131 HARV. L. REV. F. 1, 9 (2017). Assuming that Justice Kavanaugh bears some resemblance to his predecessor, Justice Kennedy, who joined Roberts's *City of Arlington* dissent, Roberts needs just one vote, most likely to come from Justice Thomas, to staunch the perceived bleeding of judicial power and end the *Chevron* era. *See id.* Were that the case, the Court would still be free to adopt the *Howey* analysis outlined above. *See supra* Section II.B. Advocates appear to see the writing on the wall, with lauded Supreme Court lawyer Lisa Blatt citing *Chevron* during oral argument with obvious hesitation: "I hate to cite it, but I will end with *Chevron*." Transcript of Oral Argument at 58, BNSF Ry. Co. v. Loos, No. 17-1042 (U.S. Nov. 6, 2018).

290 *See* City of Arlington v. FCC, 569 U.S. 290, 296 (2013) ("Congress knows to speak in plain terms when it wishes to circumscribe, and in capacious terms when it wishes to enlarge, agency discretion.").

291 *See supra* text accompanying notes 241–46. These DAOs could fall under current definitions of partnerships. *See generally* Oren, *supra* note 118 (proposing a new partnership-based business organization for decentralized organizations).

292 *See supra* Section I.B.

293 *See* U.S. CONST. art. I, § 8, cl. 3.

294 Robinson, *supra* note 71, at 929–30.

295 Courts have noted that the CFTC may receive similar deference for its definition of a commodity after rulemaking or formal adjudication. *See, e.g.*, CFTC v. Erskine, 512 F.3d 309, 314 (6th Cir. 2008).

Conclusion

What direction the ICO market will move in is anyone's guess, but it is sure to raise many exciting questions and lead to new innovations. Although this Essay generally rejects arguments that ICOs are somehow categorically distinct from other fundraising methods, it is true that ICOs raise fundamental questions about the paternalism[296] and protectionism[297] created by securities laws. But those concerns are not unique to ICOs, and arguments to the contrary have thus far not been particularly persuasive.

This Essay should not be read as disfavoring the creation of tokenized industries. The opposite is true. With rapid advances in technology, blockchain and tokenization will undoubtedly revolutionize (to what degree remains to be seen) sharing, recordkeeping, and, eventually, likely the securities industry and the fundamentals of company ownership. Tokenization will develop new business models and structures, and the blockchains may help to create intriguing new global democratic organizations. The organizational possibilities of future decentralized autonomous organizations are literally limited only by the imagination. These possibilities should be realized.

But tokens remain risky business, and appropriate regulation should be invited. The ICO market is fast moving and ever changing.[298] The money raised in 2018 exceeded the money raised in 2017 by

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296 Paternalism most commonly takes the form of restrictions on securities not publicly registered except to certain investors that fall into carefully delineated exceptions, most notably the accredited investor exception, which generally only permits the wealthy to invest in early-stage businesses. *See, e.g.*, Ripken, *supra* note 89, at 2 ("Examples of the paternalistic nature of modern securities rules abound, including bans on sales of securities to unsophisticated investors in private placement offerings . . . ."); Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 Fordham L. Rev. 3389, 3417–36 (2013) (arguing that retail investors should all be permitted to invest in early-stage investments through mutual funds). Some have used ICOs as a new launching point for the same argument. *See, e.g.*, Preston, *supra* note 37, at 331 ("[J]ustifying stiff regulations by claiming a dire need to protect unsophisticated investors smacks of misguided paternalism in an age where risk is spread amongst the millions willing to bet on a yet-unproven startup company.").

297 Since the beginning, business, politicians, and regulators have sometimes displayed mixed motives, often being swayed by those with influence to regulate in a way that favored the influencers. *See, e.g.*, Macey & Miller, *supra* note 123, at 396. This argument has been put forth in the ICO context. *E.g.*, Ras Vasilisin, *The Cryptocurrency Regulation Conundrum*, Good Audience (Sept. 19, 2018), https://blog.goodaudience.com/the-cryptocurrency-regulation-conundrum-876d3c1299da [https://perma.cc/7XWW-48LW] ("Many incumbents actually support greater levels of regulation, since regulatory suppressions often protect existing or established firms from competition, giving these firms some monopoly power and lessening their accountability to consumers.").

298 *See ICO Tracker*, *supra* note 37, (select "Summary Stats").

$11.3 billion, totaling $16.7 billion.[299] Although the crypto market is in a slowdown,[300] as the regulatory landscape becomes clearer,[301] this market will likely continue to grow. Repeated statements by SEC Chairman Jay Clayton have signaled that greater regulation and enforcement is coming,[302] and with it, likely more regulatory clarity and market maturity. This increased regulation is called for because when these companies are raising money, the tokens that they sell function as securities. This reasonable interpretation of tokens as securities by the SEC should be afforded the wide latitude to regulate ICOs guaranteed by *Chevron* because the Securities Acts broadly define securities and the SEC is better suited than the courts to respond to this unique regulatory challenge.

299 *See id.*

300 *See, e.g.*, Ian Allison, *Fund Seeks $200 Million to Help Startups Survive a Crypto Winter*, COINDESK (Dec. 11, 2018, 2:43 PM), https://www.coindesk.com/fund-seeks-200-million-to-help-startups-survive-a-crypto-winter [https://perma.cc/6Q44-C7VQ].

301 Multiple efforts to legislate and regulate appear to be ongoing, and the SEC has continued its enforcement. *See, e.g.*, Press Release, Darren Soto, Representative, U.S. House of Representatives, Rep. Soto, Members Introduce Bipartisan Bills Preventing Virtual Currency Price Manipulation (Dec. 6, 2018), https://soto.house.gov/media/press-releases/rep-soto-members-introduce-bipartisan-bills-preventing-virtual-currency-price [https://perma.cc/NL83-E8FX]; Emily Bamforth, *U.S. Rep. Warren Davidson Announces Legislation to Regulate Initial Coin Offerings at Blockchain Solutions Conference*, CLEVELAND.COM (Dec. 3, 2018), https://www.cleveland.com/news/2018/12/us-rep-warren-davidson-announces-legislation-to-regulate-initial-coin-offerings-at-blockchain-solutions-conference.html [https://perma.cc/N82Z-JECV]; Colin Harper, *"Guidance by Enforcement": How the SEC Is Slowly Shaping ICO Regulation*, BITCOIN MAG. (Nov. 30, 2018, 2:32 PM), https://bitcoinmagazine.com/articles/guidance-enforcement-how-sec-slowly-shaping-ico-regulation/ [https://perma.cc/JFB3-SZUA].

302 *E.g.*, Seward, *supra* note 96 (interview at 23:30) (discussing recent securities settlements requiring only rescission but suggesting that "remedies in future cases may be different" and admonishing token offerors with a clear message: "Get your act together").