

# Taking the “Crypto” Out of Cryptocurrencies

How securities laws and regulations impact this booming business

**D**uring 2017 it appeared you couldn't lose money investing in Bitcoin, initial coin offerings and other cryptocurrency offerings (collectively ICOs). Not since the Tulip Bubble of 1637 had prices of a single commodity (Bitcoin) gone up so much so quickly. As the price of Bitcoin skyrocketed, hundreds of other cryptocurrencies entered the market, and investors anxiously swept them up, hoping to catch the next massive bubble on the way up. Everyone was looking to be the next “Bitcoin billionaire.”

While the escalation of tulip prices to the point that bulbs were more valuable than real estate was irrational, at least anyone purchasing a tulip bulb knew what they were getting. The same can't be said for everyone who purchased cryptocurrency. Indeed, the prefix “crypto” means “secret” or “hidden,” and one of Bitcoin's principal claims to fame (and for some, its principal appeal) is the anonymity surrounding its ownership. Moreover, it is often unclear what purchasers of cryptocurrency are getting—is it currency, is it equity in a company, or is it something else?

## Are ICOs securities?

Whether you are considering conducting an ICO to raise capital, investing in cryptocurrency, or if you lost money in someone else's ICO, it is important to consider how federal and state securities laws impact the cryptocurrency world.

The first and most important question is whether securities laws even apply to sales or issuances of cryptocurrencies. Securities are more than just equity in companies or debt instruments. A broader definition also includes “investment contracts.” In 1946 the Supreme Court in *SEC v. W.J. Howey Co.* defined a security to include “an investment of money in a common enterprise with profits to come solely from the efforts of others.” In a later case, the Supreme Court stated a security encompasses “virtually any instrument that might be sold as an investment.”

Many ICOs have been conducted by “issuers” claiming that the “coins” being sold were “utility” tokens or contracts and not securities. A “utility token” gives the token holder the right of access to a particular product or service that the issuer is offering or intends to offer. In December 2017, however, the SEC warned that it considered coin offerings to be sales of securities and would regulate them as such. While this statement came as a shock to many, the SEC was simply restating long-established case law and practice used by it and other state and federal regulators.

All securities offerings must either be exempt from registration or registered with appropriate state and federal regulators. Companies are successfully completing ICOs by treating the “coin” or “overall contract” as a security by either relying on exemptions from regulation or registering the ICO using Regulation A/A+ of the Securities Act. Completing such offerings requires significant disclosure and legal compliance requirements. Securities counsel should always be consulted in any such exemptions or offerings.

While the SEC's position is clear, no court has yet issued a final opinion finding that a cryptocurrency is a security, or that ICOs are securities offerings. But the converse is also true, and no court has held that a cryptocurrency is *not* a security. Regardless, anyone wishing to push the legal envelope with a coin offering should proceed with extreme caution.

## Shaping the parameters

In January of this year, the SEC sued cryptocurrency issuer AriseBank and two founders for securities violations relating to its then-ongoing ICO. AriseBank was looking to raise \$1 billion in working capital for a “decentralized bank,” and claimed to have more than \$600 million in the door when the SEC sued. The SEC also sought and obtained an immediate injunction and seizure of assets, bringing AriseBank's business to a crushing halt.

Assets were reportedly seized at gunpoint in a dramatic scene more consistent with seizures of weapons or drugs than the proceeds of a coin offering. To the extent the SEC wanted to make a point, it was loud and clear: Coin issuers should tread lightly and proceed with caution.

On the flip side, those who invested in an ICO only to see the value of their coins diminish may have claims under applicable securities rescission laws. In Utah, for example, an issuer (as well as many of its officers) can be liable for the money raised in an ICO if the ICO failed to comply with applicable securities laws. The law in Utah permits “rescission damages” equal to a return of the investors' money *plus* 12 percent per annum *plus* attorneys' fees. Regardless of the available remedies, anyone considering investing in an ICO should find out as much as possible about what they are buying *before* forking over any money.

In summary, there is little doubt that cryptocurrencies are here to stay and ICOs will be a popular way for companies—and the investing public—to make money. While the precise parameters of the legal landscape are still very fluid, there are certainly things that both issuers and investors can do to protect themselves and maximize their chances for a positive—and lawful—cryptocurrency experience. **UB**



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