



DECEMBER 18, 2017

Let's Be Careful Out There

SEC Chair Issues Statement on ICOs; Enforcement Action Settled

Evidencing developing views at the Securities and Exchange Commission regarding cryptocurrencies and their technologically related offshoots, on December 11, 2017, Chair Jay Clayton issued a public statement warning investors and market professionals of the financial and legal risks attendant to these products — elaborating on remarks he made in November. (Read our client alert on his remarks [here](#).) On the same day, the SEC announced entry of a cease-and-desist order addressing an initial coin offering conducted by Munchee Inc., the developer of an online restaurant meal review service.

Thoughts From the Chair

Although not an official declaration of SEC policy, the notably stern and occasionally scolding (with boldface warnings) statement sets out four key principles:

- Calling a digital asset a token or including a utility feature does not prevent the token from being subject to federal securities law. Token offerings emphasizing potential investment gains that require entrepreneurial or managerial efforts of others to be achieved, or prospective secondary market trading, bear the hallmarks of a security. By and large, the ICOs that Mr. Clayton has seen have been securities offerings.
- The burden of demonstrating that a utility token or other product is not a “security” falls on the ICO’s promoters. On this point, Chair Clayton clearly charges the country’s “gatekeepers” (namely securities lawyers, accountants and consultants)

with responsibility for protecting the investing public. In addition, market intermediaries of transactions in digital assets that are securities (however denominated) must comply with applicable law.

- Recognizing technological advances that have created these instruments “may prove to be disruptive, transformative and efficiency enhancing,” the SEC does not intend to prevent their use if securities laws are not implicated.
- The SEC is very worried that individual “Main Street” investors are being drawn into these transactions without adequate information about the people involved, how investors’ funds will be used or the probability that the project’s promises will be fulfilled. The SEC chair noted that he has asked the SEC’s Division of Enforcement to police ICOs vigorously and recommend enforcement actions against those that conduct ICOs unlawfully.

Disrupted ICO

Release of Chair Clayton’s statement coincided with entry of the Munchee cease-and-desist order. The Munchee order relies on the principles expressed in the statement, albeit with more fulsome legal analysis, similar to the SEC’s Investigative Report issued in summer 2017 regarding The DAO. (Read our client alert on the investigative report [here](#).)

This publication may constitute “Attorney Advertising” under the New York Rules of Professional Conduct and under the law of other jurisdictions.

The background to the Munchee order is much different, however, than those of the other recent fraud-based enforcement actions brought by the SEC involving ICOs that purported to be backed by nonexistent assets or businesses, typically involving recidivist securities law violators. Having created an iPhone application for people to review restaurant meals, in October and November 2017 Munchee offered, and then sold, digital tokens issued on the Ethereum blockchain, to raise about \$15 million to improve its existing app and recruit users to eventually buy advertisements, write reviews, sell food and conduct other transactions using the digital tokens. Many of the features of the Munchee token offering are common to ICOs raising funds in the market at this time:

- No current functionality of the digital token.
- Plans to create and/or dramatically grow a network pursuant to a vague future timeline using funds raised in the ICO.
- Self-serving statements that the ICO did not “pose a significant risk of implicating federal securities laws.”
- Graduated token-price discounting leading investors to believe that they would miss out on the greatest returns if they delayed their investment decision.
- Extensive publicity on blogs, YouTube, podcasts and Facebook, most of which was compensated in the form of delivery of tokens.

After being contacted by the SEC staff, Munchee discontinued all ICO activity and returned the approximately \$60,000 in proceeds it had received from investors.

In finding that the Munchee tokens were securities, the SEC kept its analysis simple:

“Investors’ profits were to be derived from the significant entrepreneurial and managerial efforts of others – specifically Munchee and its agents – who were to revise the Munchee App, create the ‘ecosystem’ that would increase the value of MUN (through both an increased demand for MUN tokens by users and

Munchee’s specific efforts to cause appreciation in value, such as by burning MUN tokens), and support secondary markets. Investors had little choice but to rely on Munchee and its expertise. At the time of the offering and sale of MUN tokens, no other person could make changes to the Munchee App or was working to create an ‘ecosystem’ to create demand for MUN tokens.”

As bitcoin’s price passes \$15,000, it is likely that the U.S. regulators will continue surveilling cryptocurrency offerings and markets. Participants may be tempted to seek friendlier shores outside of the United States, although as mentioned in our last Client Alert, the international community is intensely debating the risks and benefits of ICOs, and it appears caution is the best approach for the time being.

This alert is a publication of Loeb & Loeb and is intended to provide information on recent legal developments. This alert does not create or continue an attorney client relationship nor should it be construed as legal advice or an opinion on specific situations.

© 2017 Loeb & Loeb LLP. All rights reserved.

Capital Markets Practice

NORWOOD P. BEVERIDGE, JR	NBEVERIDGE@LOEB.COM	212.407.4970
ROBERT CALDWELL	RCALDWELL@LOEB.COM	+852 3923 1115
GIOVANNI CARUSO	GCARUSO@LOEB.COM	212.407.4866
ANGELA CHAN	ACHAN@LOEB.COM	+852 3923 1176
ROY CHOI	RKCHOI@LOEB.COM	+852 3923 1138
ROBERT CHUNG	RCHUNG@LOEB.COM	310.282.2216
STEPHEN H. COHEN	SCOHEN@LOEB.COM	212.407.4279
ANGELA M. SANTORO DOWD	ADOWD@LOEB.COM	212.407.4097
ALLAN B. DUBOFF	ADUBOFF@LOEB.COM	310.282.2141
ROSS D. EMMERMAN	REMMERMAN@LOEB.COM	312.464.3357
DAVID C. FISCHER	DFISCHER@LOEB.COM	212.407.4827
STEVEN E. HURDLE, JR.	SHURDLE@LOEB.COM	310.282.2187
CHRISTOPHER J. KELLY	CKELLY@LOEB.COM	310.282.2263
WALLACE LAU	WLAU@LOEB.COM	+852 3923 1128
FRANK LEE	FLEE@LOEB.COM	212.407.4825
JADA SOYUN LEE	JSLEE@LOEB.COM	+852 3923 1150

JC LEE	JCLEE@LOEB.COM	+852 3923 1146
DAVID J. LEVINE	DLEVINE@LOEB.COM	212.407.4923
BARRY T. MEHLMAN	BMEHLMAN@LOEB.COM	212.407.4812
RIMA R. MOAWAD	RMOAWAD@LOEB.COM	212.407.4052
MITCHELL S. NUSSBAUM	MNUSSBAUM@LOEB.COM	212.407.4159
SIMONA S. PAPAIZIAN	SPAPAIZIAN@LOEB.COM	212.407.4941
ROGER C. PENG	RPENG@LOEB.COM	+86 10 5954 3552
RONELLE C. PORTER	RPORTER@LOEB.COM	212.407.4110
FRAN M. STOLLER	FSTOLLER@LOEB.COM	212.407.4935
ALLEN Z. SUSSMAN	ASUSSMAN@LOEB.COM	310.282.2375
LILI TAHERI	LTAHERI@LOEB.COM	212.407.4160
LAWRENCE VENICK	LVENICK@LOEB.COM	+86 10 5954 3688
TAHRA T. WRIGHT	TWRIGHT@LOEB.COM	212.407.4122
CANDICE YANG	CYANG@LOEB.COM	+86 10 5954 3556
JAMES ZHANG	JZHANG@LOEB.COM	+86 10 5954 3557
