

Breaking the Long Silence: The SEC Provides Guidance on Tokens (Part I)

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After what was, frankly, a painfully long period of silence, the SEC issued crypto guidance in the form of a no action letter and non-binding guidance through a digital asset framework on April 3, 2019.

Taking the no-action letter first (I will follow up on the digital asset framework in a separate post), the SEC is responding to a request from TurnKey Jet, Inc. (TKJ) which sought SEC assurances that it would not recommend an enforcement action with respect to TKJ's planned token issuances. The SEC no action letter lays out a number of factors that it considered in reaching the position that the token in question was not subject to securities laws. These are as follows:

1. The Company would not use any funds from Token sales to develop the Platform, Network, or App, and each of these will be fully developed and operational at the time any Tokens are sold;
2. The Tokens would be immediately usable for their intended functionality (purchasing air charter services) at the time they are sold;
3. The Company would restrict transfers of Tokens to Company Wallets only, and not to wallets external to the Platform;
4. The Company would sell Tokens at a fixed price (of \$1USD in this case) per Token throughout the life of the Program, and each Token represents a Company obligation to supply services at a fixed value (\$1USD) per Token;
5. If the Company offers to repurchase Tokens, it will only do so at a discount to the face value of the Tokens (\$1USD per Token) that the holder seeks to resell to the Company, unless a court within the United States orders the Company to liquidate the Tokens; and
6. The Token is marketed in a manner that emphasizes the functionality of the Token, and not the potential for the increase in the market value of the Token.

What struck me first in reading the above factors is that the features are startlingly similar to (read: exactly the same) those shopped to us by the SEC over a year ago when we spoke to them to get their impressions about a client's proposed token model. While many of the factors are unpalatable from a business perspective, factor (3) above, which restricts transfers of the token to the platform (to give the SEC assurances that there will not be a secondary (speculative) market in the token) was a non-starter. That factor, combined with the also made the token model, in that instance, dead on arrival from a business perspective.

Well, it looks like the SEC found a project willing to move forward with them. What we end up with amounts to a consumptive (utility) token model mimicking a gift card to the company, albeit with more restrictions on their use than are typically attendant to gift cards. After all, you and I are free to resell (or regift) our gift cards to Olive Garden and REI if Aunt Becky got it wrong on our last birthday. In fact, there are market places dedicated to facilitating this resale market (see CardPool, for example).

However, for 99% of projects looking to pursue a token issuance, this model would provide no upside and would entail added costs and it would make more sense to go with a traditional gift card product.

That said, the no action letter is important because it provides a line in the sand for the crypto industry to use as a baseline?—?now comes the interesting part, which is testing the line for an enforcement action as we toggle the factors above to see, on balance, which of the factors need to be in place for the SEC to determine whether a securities offering has occurred.

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